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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

No. 71-1059

KERN COUNTY LAND COMPANY,

Petitioner,

v.

OCCIDENTAL PETROLEUM CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT OCCIDENTAL PETROLEUM CORPORATION

Statutes Involved

The relevant sections of the Securities Exchange Act of 1934, 15 U.S.C. § 78, provide in pertinent part:

Section 3(a), 15 U.S.C. § 78c(a):

> "When used in this chapter, unless the context otherwise requires—
>
> • • • • •
>
> "14. The terms 'sale' and 'sell' each includes any contract to sell or otherwise dispose of."

Section 16, 15 U.S.C. § 78p:

"(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security * * * which is registered pursuant to section 78*l* of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78*l*(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission * * * of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file * * * a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer * * * within any period of less than six months * * * shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. * * * This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Section 23(b), 15 U.S.C. § 78w(b):

> "The Commission and the Board of Governors of the Federal Reserve System, respectively, shall include in their annual reports to Congress such information, data, and recommendation for further legislation as they may deem advisable with regard to matters within their respective jurisdictions under this chapter. • • •"

Questions Presented

1. Whether the court below was correct in adhering to the long-established objective test of § 16(b) and holding that respondent did not make a short-term "sale" of securities of the issuer when it granted a long-term option on unregistered and then nonexistent securities of another corporation?

2. Whether the court below was correct in holding that the merger engineered by petitioner's parent and its predecessor, in which all shareholders' investments were transformed pro rata, was not a "sale" by respondent, where respondent made no exchange of shares within six months of a purchase, there was no alternative to accepting the results of the merger, and there was no opportunity to make unfair use of inside information?

The Proceedings Below[1]

This action, filed in October 1967, was consolidated for pretrial purposes with three shareholder suits, 44 F.R.D.

1. Citations herein by page number are in the form set forth in the Brief for Petitioner (hereinafter "P.Br."). Citations to depositions indicate the name of the witness and page (*e.g.*, Symonds depos. 1). Record citations to documents not reproduced in the Appendix state the document number used in compiling the Record and the item or exhibit to which reference is made (*e.g.*, Doc't 59, Interrog. 15). Names of persons are as set forth in Petitioner's Brief except that "Old Kern" has been shortened to "Kern."

543 (S.D.N.Y. 1968). An earlier motion for summary judgment had been denied, *id.*, and following additional discovery by interrogatories, depositions and associated production of documents, in which all parties participated, petitioner and the shareholder plaintiffs moved for summary judgment in May 1970 (67a-68a; 494a-495a). The district court granted petitioner's motion for summary judgment (1C-30C) and dismissed the shareholder suits as moot (24C). The shareholders took no appeal.

On respondent's appeal the Court of Appeals for the Second Circuit, in an opinion by Chief Judge Friendly (1A-17A) for the panel, which included Judge Timbers, a former General Counsel of the Securities and Exchange Commission (the "Commission"), and Judge Moore, unanimously reversed and directed dismissal of the complaint on the undisputed facts, as respondent had requested both on brief and at argument. Petitioner did not challenge any facts upon which the court below relied until after it ruled and made no response to the court's inquiry at oral argument as to the possibility of further factual issues (17A). A petition for rehearing or rehearing in banc, in which supposed new matters were pressed, was denied unanimously by the panel and by the full court by a vote of eight to one. Petitioner's assertion here that the twenty-one volume record of this case is "limited" reverses the position it took both before the court below, where it said:

> "[E]ntry of summary judgment came after this litigation had been pending some three years and after extensive discovery had been had. . ."[2]

twice emphasizing the fullness of the factual discovery,[3] and in the district court (72a-73a), where it stated that the "Section 16(b) claims have been fully developed,"[4] urging both courts to rule on the undisputed facts.

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2. Brief for Appellee 2-3.

3. *Id.* 3, 20.

4. Memorandum of [New Kern] in Reply to Defendant's Memorandum Opposing and Intervenor's Memorandum in Partial Opposition to its Motion for Summary Judgment in 67 Civ. 4042 (June 12, 1970), at 14.

Because the court below found no sale within 6 months of a purchase as § 16(b) requires, it did not reach other issues involved in the case. These questions are not before the Court but would remain for consideration on remand if the Court should disagree with the judgment of the Second Circuit below.[5]

Counterstatement of the Case

In its "Statement of the Case" and elsewhere in its brief and petition for writ of certiorari petitioner omits relevant facts and makes certain claims that contradict the record and its own admissions therein. Respondent regrets the consequent need to expand its brief to make a fair factual presentation.

A. Occidental's Attempt to Seek a Merger With Kern

In late March and April 1967 Occidental began to explore the possibility of a merger with Kern County Land Company ("Kern") and consulted Lehman Brothers, its invest-

5. These issues are: (1) whether shares acquired by Occidental *before* it became a 10% holder are subject to § 16(b) Occidental's tender offer was so structured that each transaction with a tendering shareholder was irrevocable, and the purchase of shares from one shareholder was not dependent upon a tender by any other shareholder, so that Occidental owned beneficially, at clearly ascertainable times, less than 10% of Kern's outstanding shares. This does not, contrary to petitioner's contentions (P. Br. 13n.), involve the question in *Stella* v. *Graham-Paige Motors Corp.*, 232 F.2d 299 (2 Cir.), *cert. denied*, 352 U.S. 831 (1956), which was whether the purchase by which one becomes a 10% holder is within § 16(b), but rather the same issue ruled upon by this Court in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418 (1972), involving transactions occurring when Occidental was neither then nor thereby became a 10% holder; (2) The recoverability of regularly declared dividends as "profit"; see *Blau* v. *Lamb*, 363 F.2d 507, 528 (2 Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967); (3) the valuation of the alleged "sale" price, if either the merger or option were held to be a "sale"; (4) the propriety of granting prejudgment interest; (5) the rate of post-judgment interest; (6) Occidental's counterclaims and defenses.

ment banker, which advised that a merger would benefit both companies (338a). Occidental's interest and Lehman's subsequent advices were based on usual sources of public record (338a-340a; Commons depos. 23-26; Hellman depos. 11, 74). In mid-April of 1967 (Doc't 59, Interrog. 15) Occidental suggested to Kern a meeting to discuss a possible merger, without response (377a-378a), and Occidental therefore decided upon a public invitation for tenders of Kern shares (378a). On May 7 Occidental advised Kern that it would make such an offer (379a). On May 8 the offer was released to Dow Jones for publication, and the next day notices appeared in newspapers throughout the country (379a; Doc't 59, Ex. A-2).[6]

Effective for one month, Occidental offered unconditionally and irrevocably to purchase any Kern shares tendered up to 500,000 shares for $83.50 per share, on an order-of-receipt basis, paying an additional $1.50 per share to transmitting brokers (118a, Ex. A). Payments would be made, and were made, upon each tender (375a-376a). Occidental reserved the right to accept any tenders in excess of 500,000 shares and to extend the offer on public notice. The offering price was about $20—or thirty percent—above the Kern stock's last prior closing market price (63⅝) and was fixed with Lehman Brothers' advice, based upon published data (339a-340a; 118a, Ex. A). By May 10 the aggregate number of tenders exceeded 500,000, and on May 11 Occidental announced an extension for an additional 500,000 Kern shares (383a). The notice advised Kern shareholders to consult a "reputable independent financial adviser" (120a, Ex. B).

6. Publication of the offer was scheduled for Tuesday, May 9, and space had been reserved in the financial press for that date (378a), but it was accelerated due to a spurt of trading in Kern shares on the New York Stock Exchange on Friday, May 5, indicating the possibility of a news leak (378a-379a).

On May 8, the day of Occidental's offer, the Board of Directors of Kern met specially and determined to "use every legitimate means to frustrate Hammer's[7] ambition to take over your Company [Kern]" (398a). In a letter to Kern shareholders dated May 10 (398a-401a) it said, "Our most urgent recommendation . . . is that you do NOT tender your shares" (398a). It warned that Occidental "must" make further offers "and the price certainly would not be less" (399a). It stated that Kern had "in hand at this time a number of offers from strong and reputable corporations to discuss merger possibilities—mergers that could result in tax-free exchanges * * *" (399a), which was incorrect and misleading.[8] Arguing at length that Kern's earnings were only temporarily depressed, it urged shareholders to "retain your shares * * * and participate in the growth [ahead]" (401a), and emphasized Kern's most favorable financial prospects:

> "Armand Hammer, it must be admitted, has evaluated the Company better than have *most outsiders.* He fully appreciates the fact that our 1.8 million acres of land are carried on our books at a fraction of their market value and that no discovery value is assigned the oil reserves underlying our California lands. Obviously he, too, sees the growth ahead that we expect for KCL." (400a; emphasis added).

On May 11, on the extension of the offer, Kern sent a telegram to its shareholders, stating that "[HAMMER'S] GRAB FOR YOUR SHARES IS A RAID" and concluding "DO NOT TENDER YOUR SHARES" (401a). And on May 15 it again wrote its shareholders stating that "KCL is adamant in its position that control by Occidental would be detrimental to our Share Owners" (402a).

---

7. President of Occidental.
8. See pp. 8-9, *infra.*

This bitter campaign led the district court to find without dispute that Kern "vigorously resisted" Occidental's offer (8C). Nevertheless, Occidental renewed its efforts to open negotiations, and on May 17, with the aid of Lehman Brothers, it presented a merger plan to Kern, and then, upon learning that Kern's directors would meet on May 19 to consider merger proposals (385a), it enriched its proposal and resubmitted it on the morning of May 19, both offers made as a basis for negotiation.[9] Kern remained unwilling to negotiate with Occidental on any basis (385a; 7C). When Occidental telephoned Kern late on May 19, it was told that its directors had "already made a deal" and was instructed to "read it in the morning newspaper" (43a-44a).

Kern's news release stated that Tenneco, Inc. ("Tenneco") had offered a corporate combination[10] featuring a tax-free exchange of a new $5.50 Tenneco convertible preference stock, with a liquidation value of $100, callable in ten years at $110, for each Kern share and that Kern's directors had voted "unanimously" to accept the offer (403a-404a). Lehman Brothers estimated that the proposed Tenneco stock should be worth $105 per share (361a-362a), and Occidental noted this estimate in its report to shareholders dated May 19 (328a, Ex. D at D7-D8).

Before Occidental's tender offer Kern had no merger plans (Doc't 102, Ex. C, par. IV, A3(b)), and no offers, and the Tenneco and Occidental offers were the only ones ever received (262a-263a; Cochran depos. 141-143). The first Kern-Tenneco contact was on May 10 or 11, when the Chairman of Kern (Montgomery) and Tenneco's late Chairman

9. The proposals were not presented as hard offers because Occidental had no access to current data on the value of Kern assets (340a; Davis depos. 23).

10. For purposes of brevity we use the term "merger," although the transaction was styled as an exchange of assets for shares. See pp. 18-19, *infra*.

(Gardiner Symonds) agreed by telephone to meet (258a; 388a). Tenneco asked to examine all of Kern's records before it would consider any offer (343a). On May 11 Tenneco began a study of Kern's records, which continued through May 18 (259a). Not until May 15 did Kern and Tenneco first meet and discuss "the extent of Tenneco's interest in Kern and in a general way the broad basis of a possible corporate combination," and no offer was made (259a; 343a; 61a). Tenneco required more information before making an offer (344a; 341a), was given an office within Kern, and assembled "a great mass of detailed information" on Kern's farming, cattle, land, and oil interests (342a). Kern told Tenneco to act quickly (Symonds depos. 14) and make its best offer first (259a). Tenneco's first offer was submitted on May 18 (278a-280a) and was accepted the next day (272a-277a). For obvious strategic reasons Occidental was not made privy to Kern's plan to interpose Tenneco (388a-389a; Davis depos. 26-27). It is conceded that Tenneco, in contrast to Occidental, had access to inside information, including internal reports on oil exploration efforts, and that its offer was based thereon (341a-344a, 388a-390a; 11A n.12).

B. Aftermath of Tenneco's Offer; the Tenneco-Occidental Option Agreement

The May 19 announcement of the Tenneco proposal quashed Occidental's bid. Although its tender offer was irrevocable until June 8, after May 19 only 3,376 Kern shares were tendered on scattered dates through June 5 (387a). Given the high price of the Tenneco offer, Occidental's executive vice president, Walter Davis, believed it was clear that "even if Occidental waged a costly and bitter proxy fight, it was unlikely that the KCL-Tenneco transaction could be stopped" and persuaded Occidental's management of that view (345a). Occidental turned its attention to problems involving its $75 million minority position in Kern after the failure of its offer.

On May 22 Occidental asked to examine Kern's records in order to evaluate the fairness of the Tenneco offer, which would be put to a shareholder vote (286a-287a). Every shareholder of a California corporation has the right to inspect its share register, books of account, and director, shareholder, and committee minutes.[11] Kern refused to disclose any records unless Occidental stated in writing the reasons for its request (468a), and Occidental complied (287a-288a; 468a). On May 24 Kern refused to permit Occidental to examine or make extracts of its share register (468a) or to see any records concerning the Tenneco offer and the alleged other offers (469a).

Consequently on May 25 Occidental petitioned the California Superior Court to require Kern to disclose such records (296a-299a). On May 29 Occidental made a second written request for information, including a description and inspection of Kern's assets (289a-293a). Kern again refused to divulge such information, and Occidental filed a second petition on May 31 (474a-483a). The total of Kern's eventual disclosure met the bare legal minimum—minutes of proceedings antedating the Tenneco offer and books of account, all available by law to any shareholder—except that Kern would not produce its share register. None concerned the Tenneco offer[12] nor the claimed (but nonexistent) other merger offers (469a; 475a-476a; 389a; Doc't 59, Ex. D). Kern's president frankly admitted that Occidental

11. CAL. CORP. CODE § 3003 (West 1955) provides: "The share register or duplicate share register, the books of account, and minutes of proceedings of the shareholders and the board of directors and of executive committees of the directors * * * shall be open to inspection upon the written demand of any shareholder * * * at any reasonable time, for a purpose reasonably related to his interests as a shareholder * * *."

12. Kern claimed that no minutes relating to any merger proposals had been prepared and refused to produce meeting notes. Such notes were not specifically covered by the California statute (469a; note 11, *supra*).

never had the access to Kern's records, personnel, and confidential reports which Tenneco had been freely given (Cochran depos. 66-67).

On May 23, before Occidental saw any records, Walter Davis requested a meeting with Mr. Symonds, who said he was "very busy" and could not see him until May 30 at his home in Houston (44a; 252a). Their meeting on that date concerned the prospect that Occidental, having sought a merger with Kern, would be made a large minority shareholder of one class of Tenneco stock if the merger took place. Before the meeting Symonds and the Tenneco management concluded that was "an unfavorable part of the transaction, but we didn't think it was critical" (346a; Symonds depos. 37-38). Occidental had not won control of Kern and had no interest in a locked-in minority position in Tenneco (392a). Pursuing a logical business solution, Davis asked Symonds if he was intersted in acquiring Occidental's Kern stock, and Symonds said he was (Symonds depos. 40; Davis depos. 90-91) but suggested a "possibility of a 16B problem" (46a). Davis replied that they "obviously" could not "make any disposition of our stock or make any other moves which are illegal" and that they both would have to be guided by counsel on the matter (46a). At Symonds' suggestion (47a) the meeting was adjourned until June 1 at his counsel's office in New York.

In both its petition and brief, petitioner erroneously asserts that in the May 30 meeting Occidental made "contemporaneous threats of a proxy fight" (P. Br. 20, 31; Pet. 19) and cites Davis' statement to Symonds that "Occidental did not want to get into a proxy fight" (P. Br. 6), thereby turning the statement completely around.[13] Symonds, the

13. In view of petitioner's reliance here on erroneous statements on these and other matters, we have felt the need to set the record straight, but none of these matters would support a result different from that reached by the court below or require further consideration, since they cannot convert transactions which are not sales under § 16(b) into sales.

supposed recipient of "threats," had no recollection of *any* mention of a proxy fight in *any* meeting between Tenneco and Occidental;[14] Davis rejected any such innuendo (Davis depos. 41),[15] and both petitioner and Tenneco flatly denied any such threats in their pleadings.[16]

On June 1 Davis, with Occidental's counsel Pillsbury Madison & Sutro (Albert Brown and Bruce Mann) met with Tenneco and its counsel Cahill Gordon Sonnett Reindel & Ohl (F. Arnold Daum) at the latter's New York office. Symonds assured Davis that Tenneco would do anything within the law to aid Occidental in avoiding acts which might trigger § 16(b) liability (347a-350a; Symonds depos. 83-85).[17] The morning was spent on legal research (48a). Discussion then focused on a proposal that Occidental grant to Tenneco Corporation (a Tenneco subsidiary) a long-term option to purchase such shares of the proposed preference stock as Occidental might receive if Kern merged with Tenneco (129a-133a). Both parties' attorneys

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14. "Q. In your conversations with Mr. Davis over the May 30th-June 2nd period, was there any mention made by anyone of the possibility of a proxy fight by Occidental in opposition to the proposed sale of Kern assets to Tenneco? A. If so, I don't remember it. It was obvious that they could but I don't remember any such discussion" (60a).

15. Davis told Occidental's directors several times that a proxy fight was too costly to consider and had poor prospects (Davis depos. 28-29, 47), in which they concurred (*Id.*).

16. In actions consolidated with this case for pretrial Tenneco and and New Kern in their answers denied (36a; 39a) that the stock held by Occidental "constituted, and in fact was employed by Occidental, as a substantial threat to the approval" of the proposed merger (35a) and that:

> "Occidental threatened to vote against such plan and to solicit Kern's other stockholders to vote against it" (37a)

—*i.e.*, threatened a proxy fight.

17. Davis testified that Symonds affirmatively assured him that Tenneco would be glad to cooperate in avoiding acts which would create § 16(b) problems (347a-348a; 356a); Symonds testified that he had implied it (350a).

conferred in drafting the agreement and finalized its terms the next day (48a-49a). Both negotiators were unfamiliar with the technical requirements of § 16(b) (347a; 349a); Occidental relied entirely on the advice of counsel (48a-49a; 349a), as did Tenneco in honoring its offer to help (349a), and both negotiators were led to believe that the grant of an option did not violate § 16(b). Symonds, summarizing counsel's discussions, testified that "there might be a 16(b) problem and that counsel for Occidental and counsel for Tenneco agreed on this document, the option agreement and that was it" (350a), and believed that they had done "everything possible" to avoid triggering § 16(b): "I think we had done that * * * in writing an option to purchase Tenneco preference stock which option was not exercisable until six months after the transaction and that was as far as I knew anything about 16(b) * * *" (349a-350a). Counsel for Kern was advised by Tenneco's counsel of the grant of the option (Doc't 36, Interrog. 44) and in turn advised Kern's management that it was an option and did not violate § 16(b) (353a-354a; 359a-360a; Cochran depos. 49). Based upon such advice the Kern-Tenneco proxy solicitation material concerning approval of the merger described the option agreement but made no suggestion of any possible § 16(b) liability[18] (492a, Ex. 1 at 3; Symonds depos. 27; Doc't 110, No. 8(c)).

Occidental's counsel was also concerned over possible § 16(b) claims with regard to the proposed Tenneco stock if Occidental were to sell any Tenneco preference stock within six months of the merger (223a). Such claims could be avoided if Tenneco postponed the registration of the new stock under § 12 of the Act until after the option was exercised or expired, since the owner of unregistered shares

18. Possible corporate claims under § 16(b) must be reported as such in solicitation or offering material if they exist, SEC Schedule 14A, 17 C.F.R. § 240.14a-101, Item 7(e)(4)(1972).

would not be within § 16.[19] Tenneco agreed to do so (241a-243a). In mid-June its counsel indicated that it had taken steps accordingly, and in exchange therefor Occidental dismissed its petitions for inspection (178a-180a; 318a-320a; 327a-328a). Tenneco's chairman called this delay "a perfectly harmless thing to do" (Symonds depos. 91).

A second potential § 16(b) problem was that the transmutation of Occidental's investment, if the merger closed within six months of Occidental's purchases, might be alleged to be a § 16(b) "sale". While a proxy fight might at least have delayed the merger, Occidental could not oppose it on the merits and was disinclined to oppose it merely for delay (223a). Instead Occidental applied to the Commission for a new rule of general application, "16b-11," to exempt such cases (202a-238a). Tenneco assisted, and Occidental kept Tenneco's counsel informed of various developments[20] (239a-240a). Although Occidental had some encouragement regarding the possible adoption of such a rule (186a-187a), the Commission took no action while expressing no view on the merits of this case (104a;

19. This would avoid any allegation that Occidental was required to hold the Tenneco shares received for an additional six months after the merger, subjecting it to a *double*, more than one year, holding period (5A-6A n.6). In separate litigation it was held that the Tenneco shares were not subject to § 16(b). *Goodman* v. *Tenneco, Inc.*, 68 Civ. 184; *Feinberg* v. *Tenneco, Inc.*, 68 Civ. 350 (S.D.N.Y., July 24, 1968) (Metzner, J.).

20. The Pillsbury firm wrote to Tenneco's counsel regarding a call from Phillip Loomis, Jr., General Counsel of the SEC, relating that Mr. Loomis was "sympathetic" to the dilemma of a shareholder in Occidental's position, which might be forced to resort to litigation to stop the so-called "merger-sale" (239a-240a). On the basis of this exchange of views petitioner apparently claims that Occidental had actually decided to initiate litigation in the event no rule were adopted and the merger closing were accelerated (P. Br. 9n.). Its reference to subsequent litigation fails to note that its closing of the merger took place in violation of an injunction issued by a Texas court (435a-454a) and thus also in violation of the Plan of Merger (432a; 124a, Ex. D at D19).

180a-181a; 190a-191a; 199a-201a; 63a-66a).[21] As a further precaution Occidental thought that it had Tenneco's agreement to delay the closing if no rule were issued (347a-350a), but Tenneco disputed that its assurances included such an understanding, and the issue had no part in the decision below (17A).

Petitioner's statement of the case interlaces the Davis-Symonds negotiations with accounts of Occidental's efforts to see Kern's records, erroneously implying that by seeking inspection and otherwise Occidental pressured Tenneco into the option agreement (P. Br. 5-7). Petitioner and Tenneco pleaded otherwise, flatly denying that the purpose and effect of the option agreement was to secure Occidental's nonopposition or support (35a-37a; 39a-43a), and Tenneco maintained in its interrogatory answers that the option was not used to conciliate Occidental.[22] Occidental had already decided not to fight the merger (345a; Davis depos. 28-29); Davis told Symonds so in their first meeting (345a), and Occidental's counsel so informed Tenneco's counsel (Doc't 59, Interrog. 30; Doc't 37, Interrogs. 23, 25). Symonds testified that he neither sought nor bargained for Occidental's neutrality or favor[23] and turned aside a suggestion

21. Petitioner made no contention below that the Commission's declining to adopt a new rule has any significance. The court below noted, "It is not contended that we should draw any inferences from this, and we do not do so" (6A n. 7).

22. "INTERROGATORY No. 52. State whether the purchase by Tenneco or Tenneco Corporation of said option from Occidental was conditioned upon Occidental's either supporting the proposed sale of Kern's assets to Tenneco or agreeing not to oppose such sale. ANSWER TO INTERROGATORY No. 52. No" (366a).

23. "Q. Was there any discussion either on May 30th or June 1st or 2nd to the effect that if Tenneco bought the Kern stock from Occidental, Occidental would either vote in favor of the sale of assets or not oppose the sale of assets from Kern to Tenneco? A. To the best of my knowledge, those subjects were not mentioned" (60a).

that Occidental's possible opposition had a part in the negotiation of the option.[24] Similarly, Kern's management regarded Occidental's position to be so unimportant to approval of the merger[25] that it never considered measures to secure its cooperation or acquiescence (62a; 366a).

C. Terms of the Option Agreement

The option agreement of June 2, 1967 gave Tenneco Corporation a "call" option not on Occidental's Kern shares but on the then nonexistent Tenneco preference stock Occidental might receive if the merger were consummated. The option was exercisable only after December 9, 1967[26] and before either December 31, 1967, if the closing of the merger occurred prior to December 10, or the thirtieth day after the closing, if it occurred on or after December 10, 1967 and prior to July 1, 1968. Occidental agreed to hold its Kern shares for a term of over 6 and up to 14 months. In return for such privilege Tenneco Corporation paid Occidental a "premium" of $8,866,230 ($10 per share), but if no merger occurred by July 31, 1968, Occidental would have to return the premium and would, of course, retain its shares. The option was expressly transferable, and Occidental had no power to compel its holder to purchase any of the shares covered (129a-133a).

When the negotiations turned to such an option, Davis telephoned Donaldson Lufkin & Jenrette, Inc., a New York

24. "A. I don't think that was the reason because basically I didn't want to have, assuming that the trade went through, I didn't want to have Occidental as a large preference stockholder of Tenneco" (Symonds depos. 45).

25. Kern's president, Mr. Cochran, testified: "I felt it such a good deal I really didn't care so long as Occidental didn't own any more stock than it owned then, that even if they voted against it, our shareholders would approve it" (368a).

26. This was more than six months after both the expiration date of the tender offer and the date of the option agreement.

investment house, and asked Mr. George Gould[27] for advice on the market rate for a 6-month "call" on a stock selling in the range of the Kern shares and was advised that such a call sold for $9 to $12 a share (47a; 363a-364a; 392a; 225a). Although the option required Occidental to hold the Kern shares for over 6 and up to 14 months, and unless the merger occurred the premium would be returned, the premium was fixed low in the quoted range at $10.00. In pleadings in the cases consolidated for pretrial petitioner and Tenneco specifically denied that the premium was "wholly out of proportion to the value of the option" and that its "true consideration" was Occidental's nonopposition and dismissal of the inspection suits (37a-38a).

The $10 premium was made creditable in the event of exercise against Lehman Brothers' $105 projection of the value of the proposed Tenneco stock (361a-362a), giving the option in substance an exercise price (or "striking price") of $95. The exercise price was not below the current market value of the Kern shares, which were then trading at prices reflecting the Kern Board's acceptance of the Tenneco offer (492a, Ex. A at 6). No one at the meeting had spoken of "down payments" (364a).

In the Kern proxy statement of June 16 Tenneco Corporation stated that it

> "has not determined whether it will exercise its option, ... Depending upon future investment market conditions, Tenneco Corporation may sell the option or the Preference Stock covered by the option; its present intention is not to purchase such Preference Stock as an investment" (492a, Ex. 1 at 3).

27. Petitioner's brief suggests that the identity of the advisor at the Donaldson firm to whom Davis spoke was not a matter of record (P. Br. 25).

Tenneco Corporation did not exercise the option.[28] To comply with a tax ruling, the option was sold on August 16, 1967 to the investment banking firm of Loeb, Rhoades & Company, which thereafter assigned it to the LR Fixed Investment Trust (83a; 225a). Occidental had no part in either transaction (60a).

D. The Plan of Merger

The Plan (124a, Ex. D) was based upon the offer approved on May 19 by Kern's Board (278a-280a) and provided for the sale of Kern's assets to New Kern, a Tenneco Corporation subsidiary, in exchange for one share of the new Tenneco preference stock for each share of Kern stock.[29] Consummation of the merger was contingent on shareholder approval, numerous conditions as to the financial condition of the two companies, the accuracy of representations as to such conditions as of the closing date (124a, Ex. D at D2-D22), a favorable tax ruling (*Id.* D22), and issuance of necessary permits by the State of California (*Id.* D22). The Plan called for a closing between September 30 and December 31, 1967 or at "such other time" as the parties might agree upon (*Id.* D17) and contained omnibus clauses under which the parties could change any terms and waive compliance with any conditions (*Id.* D24).

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28. The opinion of the district court was in error on this point (17C).

29. The new Tenneco stock had a cumulative quarterly dividend of $1.375 fixed by the Tenneco charter. After July 1, 1969 it became convertible into 3.6 shares of Tenneco common stock (124a, Ex. D at D74-D78). As indicated, it would be issued at first without registration under the Act and thus was not initially tradable on a national securities exchange (144a; 410a). The opinion of the district court was in error as to the convertibility of the stock during the relevant period (9C).

E. Shareholder Approval of the Transaction

Kern's management was unconcerned about any opposition by Occidental (368a). The combination was cast as an exchange of assets instead of a merger, enabling its approval by a majority of shares rather than a two-thirds vote and foreclosing any right of appraisal (492a, Ex. 1 at 4).[30] Since shareholders were voting on a 50% increase in the value of their pre-tender offer holdings and a dividend "more than twice as great" as the regular Kern dividend (*Id.* 3), Kern's confidence was justified. By July 5 it had sufficient proxies to pass the Plan; at that time only 0.5% were opposed (Doc't 37, minutes of July 6). At the July 17 special meeting the Plan was approved by over 99% of all shares voted (70.18% of shares outstanding), with Occidental abstaining (269a).[31]

A representative of Occidental appeared at the meeting and read a letter explaining why it did not vote for the merger: that it could not make a better proposal; that it could not get more information on Kern's assets without expensive litigation; that, without making a better offer than Tenneco's its opposition could not be justified; that because it would have preferred an Occidental-Kern merger, it was abstaining; but that it did not challenge the fairness of the proposal (269a; 413a-415a).

F. Acceleration of the Merger Closing

On August 4 Kern and Tenneco executed a "Supplementary Dividend Agreement," reciting their wish to close quickly and enabling them to close before the dates set forth in the Plan and proxy statement (84a; Doc't 129, Ex. A;

30. CAL. CORP. CODE §§ 3901, 4123 (West 1955), 4107, *as amended* (Supp. 1972).

31. This constituted a vote against the proposal under the law governing the proceedings. CAL. CORP. CODE § 3901 (West 1955); 492a, Ex. 1, inside cover page.

192a). Davis went to Symonds and asked him to postpone the closing until December but was refused (355a-358a).

Tenneco applied to the California Commissioner of Corporations for a permit to issue the new preference stock, which was granted over Occidental's objections (181a-197a) on August 30, 1967, and Kern and Tenneco closed on the same day (152a-153a). Concurrently Kern separately assigned to New Kern, in consideration of $10, any and all claims it had under the Act (134a; 83a). The next day Kern wrote its shareholders, announcing that they were "entitled to receive, upon surrender of your certificates of Kern Capital Stock," an equal number of the new Tenneco shares (153a).

G. The Sale

Occidental did not surrender its Kern shares until December 11, 1967 (4a; 13a; 83a). On that day the LR Fixed Investment Trust chose to exercise its option. Occidental tendered its Kern shares for the new Tenneco stock and then delivered sufficient shares to the optionee to meet its obligations under the agreement. The LR Fixed Investment Trust paid Occidental $95 per share, as provided in the option, or $84,229,185 (*Id.*). There are no "short-swing profits" involved in this case.

Summary of Argument

Section 16(b) is a special recovery tool, enacted to deter the unfair use of inside information, and is triggered only by a statutory insider's matched purchase and sale within 6 months of an equity security of the issuer corporation. Petitioner, however, urges the Court to broaden § 16(b) to cover transactions which Congress has excluded from it and to do away with the 6 month rule and other statutory provisions, in the face of the rejection of any such judicial expansion by this Court in *Reliance Electric Co.* v. *Emerson*

Electric Co., 404 U.S. 418 (1972), and *Blau* v. *Lehman*, 368 U.S. 403 (1962), and by the courts of appeals. With no viable policy argument to support it, it would have the Court overturn uniform precedent to impose liability in a case where no abuse of inside information did or could occur, and in which the expressed purpose of the statute cannot possibly be served.

The grant of an option differs basically from a sale of stock, and the difference is decisive under § 16(b). The long-established rule, applied judicially and administratively, is that no "sale" under § 16(b) occurs unless and until both the investor's rights and obligations to sell are fixed and certain. The investor must at least acquire a right to sell shares at a fixed price before § 16(b) may arguably come into play. But one who grants an option makes no "sale" in fact or under § 16(b), *Silverman* v. *Landa*, 306 F.2d 422 (2 Cir. 1962), because he obtains no such right but remains at the risk of the market and the pleasure of the optionee and neither terminates his risks nor realizes any profit.

While in the *Reliance* case and *Blau* v. *Lehman, supra*, this Court rejected "persuasive" and logical arguments for the judicial expansion of § 16(b), here petitioner's argument rests on inaccurate statements as to options and conflicts with the logic of the statute itself. Rather than constituting a device to insure profit, the grant of an option is a risk-bearing encumbrance upon the grantor, which worsens his speculative position and limits his potential profit in relation to the investment and risk assumed. Inherently, it bears no resemblance to the class of transactions which Congress deemed necessary to penalize. Moreover, the option here could be exercised only more than 6 months after the date of its grant, beyond the period when the statute deems inside information to be effective, and could not be included under the statute without an additional violation of its express terms.

All precedent is contrary to petitioner's position, including *Bershad* v. *McDonough*, 428 F.2d 693 (7 Cir. 1970), *cert. denied*, 400 U.S. 992 (1971), which shows by contrast the correctness of the decision below. There the defendant had granted no option in fact, which entails a premium above a stock's current market price, but had instead demanded a down payment of a substantial part of its price. It was a so-called "deep in the money" spurious option, wherein the down payment so lowered the exercise price of the purported "option" that the defendant made abandonment of the sale all but impossible in the *short-term* period during which the remaining installment could be paid. Coupled with the immediate passage of virtually all incidents of stock ownership, that agreement was merely a disguised sale under the test correctly articulated and applied here by Judge Friendly.

The option here bears no resemblance to the *Bershad* agreement, and there is no basis for finding that it was other than an option. The circumstances in *Bershad* have no counterparts here, and the array of irrelevant factors pressed by the petitioner cannot through some "ad hoc" alchemy convert an option into a sale, and that disposes of matter under § 16(b).

Nor may Kern's and Tenneco's merger artificially be labeled a "sale by Occidental." No case decided under § 16(b) has suggested that an event controlled by others which gave a defendant no option not to participate could be labeled as *his* "sale," and petitioner has failed to establish any sale or exchange by Occidental within 6 months of a purchase. Even if this fatal defect in its case were passed over, application of the accepted "possibility of abuse test" yields exactly the same result. A merger conceived after an investor has irrevocably offered to buy shares, and in which all shareholders' investments are altered on a pro rata basis, cannot serve as a vehicle for special insider's

profit, no matter what informational advantage concerning the issuer the investor may later acquire, and here did not acquire.

Petitioner's position fails to meet the requirements of § 16(b) and cannot serve the statutory purpose, but instead would impose a whole range of new abuses and burdens on both stockholders and the courts. It would force defeated tender offerors to engage in groundless opposition merely to delay mergers, while giving incumbents and their favored merger partners overpowering new weapons against tender offers through manipulation of the statutory scheme. It would make liability turn upon a bizarre contest between competing bidders to accelerate or retard the closing of a merger. It is a perversion of the statute's purpose in its own right and would thwart the most recently expressed policy of Congress, which took "extreme care" to maintain the competitive balance in contests for control.

No exemption or "ad hoc" inquiry is necessary to reject the two baseless theories by which insiders-in-fact sought to take advantage of a past competitor's entangled situation by attaching the artificial label of "insider" to him, in order to gain a windfall recovery. The court below properly rejected these on their merits, consistently with the uniform, indeed exclusive, interpretation of the statute.

POINT I

The Grant of an Option to Buy was not a "Sale" by Occidental, Nor May It Be Deemed Such.

A. Section 16(b) Has No Application to the Grant of an Option.

Section 16(b) was enacted to counter sure-thing trading by officers, directors, and large shareholders "in the stock of their own companies with the benefit of advance information," S. Rep. No. 792, 73rd Cong., 2d Sess. 9 (1934). "The expressed purpose of this provision is to prevent the unfair use of inside information," *id.* 21, which may accrue to an insider "by reason of his relationship to the issuer," 15 U.S.C. §78p(b). It is a rule of automatic recovery which is as limited in its scope and purpose as it is severe in its impact.

Section 16(b) is triggered only by a statutory insider's matched purchase and sale of an equity security of his corporation within 6 months and leaves untouched such transactions 6 months and 1 day apart, trading by large shareholders owning less than 10%, and shareholder transactions before 10% ownership is reached and after it is relinquished.

> "[I]ts general purpose is to preclude the unfair use of inside information which may have been obtained by corporate insiders. . . . But Congress did not seek to accomplish the whole of this purpose by Section 16(b) alone. Section 16(b) creates a special remedy applicable only in a limited situation. . . . [O]ther remedies are . . . available, but only upon proof of actual wrongdoing."

Blau v. *Max Factor & Co.*, 342 F.2d 304, 307 (9 Cir.) (footnote omitted), *cert. denied*, 382 U.S. 892 (1965); see *Reliance Electric Co.* v. *Emerson Electric Co.*, *supra*, 404 U.S.

at 422; *Adler* v. *Klawans*, 267 F.2d 840, 845 (2 Cir. 1959). Courts have repeatedly rejected litigants' assertions of "other possible abuses" of conversions, options, dividend practices, or corporate position as either a basis for, or as "coloration" to induce, a finding of § 16(b) liability.[32] The list of acts, persons and abuses within the scope of its "extraordinary liability," *Blau* v. *Lehman, supra*, 368 U.S. at 409, may not be broadened, and this Court has so held on both occasions on which it considered the statute. *Reliance Electric Co.* v. *Emerson Electric Co., supra; Blau* v. *Lehman, supra.*

This view contrasts with that taken of § 10, the Act's broadly-based antifraud provision, which partially overlaps in purpose with § 16(b) but has a different function. Section 10 offers a federal remedy against those who are proved to have done actual harm, whereas § 16(b) imposes liability without proof of harm.[33] Because acts which trigger § 16(b)'s automatic recovery may be inherently innocent, efforts taken to avoid liability are not disapproved. "[T]here is no reason why a person may not conduct his business in such a way as to . . . eliminate his loss of profits

32. *Blau* v. *Max Factor & Co., supra; Blau* v. *Lamb*, 363 F.2d 507, 521, 522-23 n. 22 (2 Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967); *Blau* v. *Ogsbury*, 210 F.2d 426, 427 (2 Cir. 1954); *Falco* v. *Donner Foundation, Inc.*, 208 F.2d 600, 604 (2 Cir. 1953); *Truncale* v. *Blumberg*, 80 F. Supp. 387, 391 (S.D.N.Y. 1948); see *Roberts* v. *Eaton*, 212 F.2d 82, 85 (2 Cir.), *cert. denied*, 348 U.S. 827 (1954); *Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 235 (2 Cir.), *cert. denied*, 320 U.S. 751 (1943).

33. Compare, *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972); *Superintendent of Ins.* v. *Bankers Life and Casualty Co.*, 404 U.S. 6 (1971); *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301 (2 Cir. 1971), *cert. denied*, 404 U.S. 1005 (1972); *Heit* v. *Weitzen*, 402 F.2d 909 (2 Cir. 1968), *cert. denied*, 395 U.S. 903 (1969). Indeed, the efficacy and breadth of § 10 eliminates any need for expansion of § 16(b). See, *e.g.*, Lowenfels, *Section 16(b): A New Trend in Regulating Insider Trading*, 54 CORNELL L.Q. 45, 61-64 (1968); Note, *Reliance Electric and 16(b) Litigation: A Return to the Objective Approach?*, 58 VA. L. REV. 907, 914-915, 928-929 (1972).

under Section 16(b) by any means permitted by law." *Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F.2d 918, 925 (8 Cir. 1970), *aff'd*, 404 U.S. 417, 422 (1972). Also, because recovery is not premised upon wrongdoing, adherence to precedent has been specially emphasized so that unambiguous warning may be given. See *Blau* v. *Lehman*, 286 F.2d 786, 789 (2 Cir. 1960), *aff'd*, 368 U.S. 403, 413 (1962).

The contention that one who grants a "call" thereby "sells" his shares under § 16(b) is devoid of logical support and contrary to precedent. A "call" is an option which gives a person the right to buy from the grantor a specified amount of securities at a stated price within a certain time.[34] The respective positions of the grantor ("optionor") and the holder of an option ("optionee") are entirely different. The holder acquires the "right to choose to conclude or not to conclude a particular transaction" at some future time, *Bershad* v. *McDonough*, 300 F.Supp. 1051, 1053 (N.D. Ill. 1969), *aff'd*, 428 F.2d 693 (7 Cir. 1970), *cert. denied*, 400 U.S. 992 (1971), which gives him, in consideration of a minimal payment, firm assurance that he can acquire an equity position at a fixed price, with no obligation ever to purchase. The grantor, on the other hand, offers to deliver shares at a stated price, if and when called upon to do so, but acquires no right to cause any sale of shares at any price or time. He may be required to sell at the pleasure of the holder, but he retains his shares at the risk of the market. The grant of an option thus lies wholly outside the scope of § 16(b).

The "long-established criteria" of § 16(b) (P. Br. 13-14) are that there is neither a "purchase" nor "sale," nor a "contract to" purchase or sell under § 3(a)(13), (14) of the

34. A "put" is an option which gives a person the right to sell to the grantor of the put a specified amount of securities at a stated price within a certain time.

Act, unless and until both the rights and obligations of an investor to acquire or dispose of securities at a stated price are fixed. *Stella* v. *Graham-Paige Motors Corp.*, 232 F.2d 299, 301 (2 Cir.), *cert. denied*, 352 U.S. 931 (1956); *Falco* v. *Donner Foundation, Inc.*, 208 F.2d 600 (2 Cir. 1953); *Shaw* v. *Dreyfus*, 172 F.2d 140 (2 Cir.), *cert. denied*, 337 U.S. 907 (1949); *Park & Tilford, Inc.* v. *Schulte*, 160 F.2d 984 (2 Cir.), *cert. denied*, 332 U.S. 761 (1947).[35] The test's minimum requirement is that the investor have a *right* to acquire a security position (in the case of a purchase) or a *right* to terminate a security position (in the case of a sale) at a fixed and determinable price.[36] Until his right to dispose of shares has thus been fixed, he bears the risk of loss of his entire equity investment; no sale may ever occur; and all questions of profit and loss are wholly problematical. The long-established test of when those prospects are extinguished is an *objective* one, conforming to the section's "mechanical" quality. See *Reliance Electric Co.* v. *Emerson Electric Co., supra*, 404 U.S. at 425; see also *Marquette Cement Mfg. Co.* v. *Andreas*, 239 F. Supp. 962, 967 (S.D.N.Y. 1965).

In *Blau* v. *Ogsbury*, 210 F.2d 426 (2 Cir. 1954), holding that an optionee's "purchase" occurred when an option was exercised, not when it was granted nor when payment pursuant to its exercise was made, the court emphasized that governing precedents had:

> "expressly stated that the time when the alleged insider's rights and obligations became fixed was controlling in the application of the statute. See also 59

35. See also the opinion issued by the General Counsel for the Commission, SEC Securities Exchange Act Release No. 116 (March 9, 1935); Cook & Feldman, *Insider Trading Under the Securities Exchange Act*, 66 HARV. L. REV. 385, 401-02 (1953) (beneficial ownership).

36. No case has deviated from this principle. See, *e.g.*, *Booth* v. *Varian Associates*, 334 F.2d 1 (1 Cir. 1964), *cert. denied*, 302 U.S. 892 (1965).

> Yale L.J. 510, 520; 65 Harv. L. Rev. 997." 210 F.2d at 427,

and continuing, it isolated the *sine qua non* of a "purchase" or "sale" under the statute:

> "What [the insider] needs is *firm assurance* that a fixed quantity can be acquired or disposed of at a fixed price; and his commitments are on that basis." *Id.* (Emphasis added)

In *Silverman* v. *Landa*, 306 F.2d 422 (2 Cir. 1962), *aff'g*, 200 F. Supp. 193 (S.D.N.Y. 1961), the Second Circuit specifically held that the grant of an option was not a "sale" of equity securities. There a director granted three options. Two (like the option here) were "calls," each giving the optionee a one-year right to purchase 500 shares at a specified price from the defendant, and the other was a "put" on 500 shares. The defendant received $2,000 (a 16.4% premium) for each call and $1,000 (an 8.2% premium) for the put, the exercise price in each case being $24⅜. Plaintiff argued, as does petitioner here, that the grant of the options constituted matched purchases and sales or "contracts" to do so under § 3(a)(13) of the Act and that therefore the director had "realized" $4 per share on the call and $2 per share on the put. After restating the principles set forth in the prior cases, the court of appeals said:

> "Plaintiff misconceives the nature of an option. By its nature, the option is one-sided; it fixes the *obligations*, but not the *rights*, of the issuer. Landa cannot be said to have 'sold' or 'purchased' Fruehauf stock; . . . *most importantly, any change would occur at the pleasure of the optionee.* Only if both the options had been exercised within their first six months would there have been a 'sale and purchase' of the underlying security within the reach of § 16(b)." 306 F.2d at 424 (Emphasis added).

Rejecting the arguments of both the Commission and the plaintiff, who put forward an incorrect interpretation of *Blau* v. *Ogsbury, supra,*[37] the court reemphasized that a chargeable disposition must include a firm right to sell, pointing out that in *Ogsbury,*

> "the insider was the *optionee;* his exercise of the option fixed his position as to the underlying security, thus acting as a 'purchase.' And here, as we have pointed out, *the insider-optionor's position in the underlying security is not fixed when he sells the option, but when the option is exercised and the underlying security changes hands.*" 306 F.2d at 424-425 n.4) (Emphasis added to emphasis in original).

Answering the plaintiff's additional contention that the grant of a call option was a short sale of securities prohibited by § 16(c), the court said:

> "Here again our holding that a *call-option is not a sale of the underlying security demolishes the plaintiff's contention.*" 306 F.2d at 425 (Emphasis added).

Petitioner makes no mention of these established principles but instead plays upon (P. Br. 13, 15, 16, 17) the "dictionary" characterization which Judge Friendly used to set the grant of an option apart from the "contextual" sense of § 3(a)(14), which has uniformly been recognized as requiring a bilateral contract of sale. This strained semantic argument has long since been rejected:

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37. The Commission argued that since in *Blau* v. *Ogsbury, supra,* the defendant was held to have purchased when by exercising the option he became *obligated* to do so, the defendant Landa should be held to have purchased and sold when he incurred an obligation to offer to do so, arguing that *Ogsbury* was therefore "dispositive of the question." Brief for SEC as Amicus Curiae 12. It was to this argument that the statement quoted by petitioner (P. Br. 16n.) was directed. The error in the argument, as the court pointed out, was its failure to add that Ogsbury, as the option *holder,* already had the *right* to purchase the securities when he, by exercising the option, also became obligated to do so. By exercise *both* his rights and obligations became fixed.

> "[T]he issuer of the options has contracted to purchase and sell the underlying securities, but only when, as and if the option is exercised. . . . they were nothing more than irrevocable *offers* for one year to buy and sell. . . . It is only by an involved process of semantics that these two options can be considered a 'purchase' and 'sale' contemplated by § 16(b). . . . each is conditioned upon an exercise within the time limitation plus the possibility that they would expire without being exercised. To us the 'context otherwise requires.'" *Silverman* v. *Landa*, 200 F. Supp. 193 at 196 (Emphasis original).[38]

This objective test for determining whether and when a sale occurs has been the exclusive interpretation of § 16(b), and "Congress is the proper agency to change an interpretation of the Act unbroken since its passage, if the change is to be made. . . ." *Blau* v. *Lehman, supra*, 368 U.S. at 413; accord, *Reliance Electric Co.* v. *Emerson Electric Co., supra*, 404 U.S. at 427-28. The result in *Silverman* v. *Landa, supra*, was reported to Congress by the Commission under § 23(b) of the Act, 28 SEC ANN. REP. 128 (1962), and Congress, which could if it wished add to the kinds of transactions subject to this extraordinary recovery mechanism, has shown no inclination to do so.

These decisions correspond with the administrative application of the statute, see *Reliance Electric Co.* v. *Emerson Electric Co., supra*, 404 U.S. at 426; *Blau* v. *Lehman, supra*, 368 U.S. at 413. At the time of these events Rule 16a-6, 17 C.F.R. § 240.16a-6 (1961), did not require the grantor of an option to report the grant under § 16(a), but concerned only trading in option rights by their holders.

38. See *Shaw* v. *Dreyfus, supra*, 172 F.2d at 142, where, referring to warrants (options) issued by the corporation, the court said: "The rights were not themselves a contract to acquire shares; they were mere offers by the corporation, which the offeree by acceptance could convert into contracts to purchase; but unless he did so, they remained *mere offers*." (Emphasis added).

Rule 16a-6 was originally numbered as Rule X-16A-1(h),[39] and the Commission's official release explaining the rule stated: "The new rule X-16A-1 requires the holders of options, puts, calls, spreads and straddles to file the reports required by Section 16(a)."[40] In the same agency year the Commission exercised its exemptive power under § 16 by adoption of Rule X-16A-10, which exempts from § 16(b) transactions which need not be reported under § 16(a), stating, "Section 16(b) liability should not be predicated upon any transactions which are not subject to the reporting requirements of Section 16(a)."[41] Pursuant to § 23(b) the Commission reported the adoption of both rules to Congress:

> "Rule X-16A-1 was amended to require holders of options, puts, calls, spreads and straddles to file the reports required by Section 16(a). . . . Rule X-16A-10 was adopted in order to exempt from Section 16(b) those transactions which need not be reported pursuant to the requirements of Section 16(a)." 19 SEC ANN. REP. 45 (1953).

In 1972 the Commission revised Rule 16a-6 to "require the reporting of certain additional transactions"[42] and for the first time made the grant of an option a reportable event[43]

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39. The repositioning of Rule X-16A-1(h) as Rule 16a-6 was in connection with the revisions of Forms 3 and 4 and was described by the Commission as "largely technical in nature." SEC Securities Exchange Act Release No. 6435 (Dec. 12, 1960).

40. SEC Securities Exchange Act Release No. 4754 (Sept. 24, 1952).

41. SEC Securities Exchange Act Release No. 4801 (Feb. 20, 1953).

42. SEC Securities Exchange Act Release No. 9499 (Feb. 23, 1972).

43. Even transactions reportable under § 16(a) are not thereby chargeable under § 16(b). As the Commission stated in its release accompanying the revision of Rule 16a-6, "Reporting changes in beneficial ownership . . . does not necessarily mean that liability will result therefrom under Section 16(b) of the Act." *Id.* "It is recog-

(viz: "The *granting*, acquisition or disposition. . . ."), but only if the option is presently exercisable (. . . of any presently exercisable put, call, option [etc.] . . ."), 37 Fed. Reg. 4329 (1972) (emphasis added). The revised rule further states, "[I]f any such right or obligation is not initially exercisable, the granting and acquisition thereof shall be reported in a statement filed for the month in which it became exercisable." *Id.* Thus, under the rule then in effect Occidental was not required to report its grant of an option, and even under the revised rule no reportable event would have occurred until December 11, 1967, more than the statutory six months after *both* Occidental's most recent purchase of shares and the grant of the option.[44]

Petitioner ignores these established principles and instead takes language from unrelated contexts, including that in *Ferraiolo* v. *Newman*, 259 F.2d 342, 345 (6 Cir. 1958), *cert. denied*, 359 U.S. 927 (1959) (P. Br. 16), which articulates the "pragmatic" or "possibility of abuse" test, under which courts have refused to impose liability where the law's purpose could not be served, to avoid the inequitable, if not unconstitutional,[45] result of "purposeless harshness."

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nized that many reports are required by Section 16(a) of transactions which are not subjected to Section 16(b) liability." SEC Securities Exchange Act Release No. 4801 (Feb. 20, 1953). The test under § 16(a) is beneficial ownership, which is broader than the purchase and sale test of § 16(b). See, *e.g.*, *Newmark* v. *RKO General, Inc.*, 425 F.2d 348, 356 (2 Cir.), *cert. denied*, 400 U.S. 854 (1970); 2 L. Loss, Securities Regulation 1100 (2d ed. 1961), since § 16(a) serves additional purposes. See, *e.g.*, H.R. Rep. No. 138, 73rd Cong., 2d Sess. 13 (1934).

44. In fact no report would have been required in this case under either rule since the option was on the unregistered Tenneco shares, which were not subject to § 16.

45. Due process objections to § 16(b)'s taking of property without proof of wrongdoing have been overcome on the basis that Congress could, based upon the legislative factfinding which preceded § 16(b)'s passage, act broadly against transactions exhibiting a "tendency to evil" and even ban them altogether. *Smolowe* v. *Delendo Corp.*, *supra*, 187 F.2d at 60. If the transactions involved do

See *Blau* v. *Max Factor & Co., supra,* 342 F.2d at 307. But in all such cases the event in question was an actual exchange of shares by the insider, and such acquisition or disposition by him fell within the literal boundaries of the Act, *Petteys* v. *Butler,* 367 F.2d 528, 533, 538 (8 Cir. 1966), *cert. denied,* 385 U.S. 1006 (1967), arguably triggering the statute under the established test. None of these cases has expanded the statute to include nonsale events or suggested it should be done, and *Silverman* v. *Landa, supra,* so held. The district court stated:

> "Here Landa undoubtedly received a substantial consideration for the giving of the options. But they were nothing more than irrevocable *offers* for one year to buy and sell." 200 F. Supp. at 196 (Emphasis in original).

And the Second Circuit in affirming stated:

> "[T]he statute did not intend to penalize *every* speculative transaction; otherwise it would not have *categorically limited* its impact to purchases and sales within six months. Merely because the options may have been entered into for a speculative purpose, it does not follow that they constitute purchases and sales of the types that were penalized." 306 F.2d at 425 (Emphasis added to emphasis in original).[46]

The *Reliance Electric* decision also rejects petitioner's expansive argument. The Court rejected the contention that Emerson's "second sale" should be deemed to have occurred at the time of its first sale, see 404 U.S. at 432, although it

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not carry such a "tendency to evil," this basis of constitutional support is eroded. The "pragmatic" test and this constitutional basis would appear to be similar if not identical.

46. The *Silverman* decision followed *Ferraiolo* v. *Newman, supra,* and *Blau* v. *Lehman, supra,* in which the Second Circuit cited *Ferraiolo* and noted that there was "no rule of thumb" for unusual exchanges, 286 F.2d at 786.

did not occur then but 13 days later. Here petitioner argues that Occidental should be "deemed" to have sold at the time the option was granted, even though Occidental did not do so and acquired no right to do so, and the sale occurred fully 6 months and 10 days later, when the investment trust chose to exercise the option. In addition, as the dissenting opinion in *Reliance* points out, the statute distinguishes between selling within 6 months of a purchase but shortly after 10% beneficial ownership has ceased, as was the case there (since the presumed knowledge which motivates the first sale would be equally relevant to the second), and, on the other hand, holding shares at risk for 6 months into a period where the statute curtails any presumption that the "useful life" of inside information is sufficient to protect against adverse market risks, as was the case here. 404 U.S. at 442.

Moreover, in *Reliance* the Court stated that a "plan" to sell conceived within 6 months of purchase clearly could not be a basis for liability. 404 U.S. at 423. The grantor of an option is in a worse speculative position than an investor who has concretely conceived a plan to sell. The latter could abandon his plan, while an option grantor cannot free himself of the encumbrance placed on his stock even if market conditions make that position unfavorable. The principles applied in both the majority and minority opinions in the *Reliance* case are wholly inconsistent with petitioner's position here.

Unable to distinguish the holding in *Reliance*, petitioner seizes upon the Court's footnote reference to *Bershad* v. *McDonough, supra,* and its truncated form of citation appropriate in such reference. 404 U.S. at 424 n.4. It suggests that the Court gave approval to a theory that the grantor of an option "sells" shares by writing an option, contrary to existing law, when the courts of appeals had not yet begun to grapple with the arguable idea that the acqui-

sition of a *right* to purchase or sell alone might trigger the Act, a question noted but reserved in the opinion below (16A). We think no such approval was given, for even the *Bershad* decision clearly did not so hold.[47]

In fact petitioner does not appear seriously to contend that an optionor disposes of stock in granting an option but rather argues that the receipt of a premium triggers § 16(b) liability, claiming incorrectly that the premium constitutes or "maximizes" profit. Because petitioner admits that its theory does not require that there ever be a sale of shares (P. Br. 15, 22), much less a sale within 6 months of a purchase, it is manifestly outside the terms of § 16(b). In both the *Reliance Electric* case and *Blau* v. *Lehman, supra,* the court refused to broaden § 16(b) despite "persuasive" and logical arguments to the contrary. 404 U.S. at 424; 368 U.S. at 411. In contrast petitioner's argument to expand the statute is specious, rests upon false notions as to options, and conflicts with the logic of the statute itself.

The grant of a call option does not "maximize" profit; to the contrary, it *limits* but does not insure any profit. The grantor has no right to "put" the stock to the optionee and fully retains the risk of loss on the shares. If he holds the stock his risk exposure is the entire value of the stock. If

47. The court in *Bershad* specifically removed itself from what it thought was a "pragmatic"-"objective" debate and stressed its intention solely to examine the "commercial substance of the agreement," 428 F.2d at 697 & n.5, exactly as the court below did. The opinion turned to a discussion of options, and then, as one commentary put it, "the court did something of an about-face, holding that the agreement in fact did not involve an option, but instead involved a present sale of McDonough's stock. . . . One noteworthy aspect is that the court confined its holdings to the facts of the case rather than enunciating any rules of general application to options." Gadsby & Treadway, *Recent Developments Under Section 16(b) of the Securities Act of 1934,* 17 N.Y.L. FORUM 687, 704-705 (1971); see Note, *Reliance Electric and 16(b) Litigation: A Return to the Objective Approach?, supra* note 33, at 926. The facts of the *Bershad* case, which involved no true option, are treated in detail *infra* at pp. 44-47.

he does not own stock he can write an option "short," in which case he may be required to buy stock in a rising market to deliver it under the option, and his risk exposure is indeterminate.[48] The grantor limits his possible gains, because the only consideration which the option gives him is the premium, and this is not "profit," for the question of profit turns on later events. His potential losses are not similarly limited. In addition to his downside risk, the grantor loses as the price of the stock increases above the option's exercise price, and he suffers a loss on the transaction if the price increases beyond the premium received. As stated by Professors Jennings and Marsh, commenting upon *Silverman* v. *Landa, supra*:

> "The writing of a put, call or straddle has exactly the opposite economic effect as the acquisition of one. The writer of an option has not improved his economic position for speculation, but has worsened it (for which naturally he charges a price)."[49]

In arguing that the grant of an option gives or "assures" profit, petitioner simply ignores the concurrent encumbrance on the grantor's shares, arguing as if the grantor had received the premium with no continuing obligation to deliver stock upon call, thus treating the premium as "free money," which is patently incorrect.

Petitioner's entirely unexplained assertion, that a statutory insider can advantage himself in granting an option, would presumably be based upon the premise that he could foresee that there would be no increase in the value of the stock during the term of the option larger than the premium received, and that he would assume the risks

48. In the case of an option written "short" the maintenance of 30% of current market value in a margin account is required. See Federal Reserve Board Reg. T, 12 C.F.R. § 220.122 (1972).

49. R. JENNINGS & H. MARSH, SECURITIES REGULATION: CASES AND MATERIALS 1076 (2d. ed. 1968) (Emphasis added).

of the option just to gain *some* of the premium.[50] Because option premiums are calculated as a relatively small percentage of the current price of the underlying stock—an average of 10 to 14% based on market experience—the price movement necessary to defeat the investor's objective is equally small.[51] And, because the option in this case was exercisable only *after 6 months,* the basis of petitioner's argument conflicts with the scope of § 16(b). Just as an insider's information is presumed to be sufficient to profit in short-term price conditions, that presumption is *absolutely* withdrawn when the hypothesized advantage depends upon a projection by the insider of price conditions more than 6 months ahead. *Silverman* v. *Landa, supra,* 306 F.2d at 425; see *Reliance Electric Co.* v. *Emerson Electric Co., supra,* 404 U.S. at 442 (*dissenting opinion*); *Blau* v. *Max Factor & Co., supra,* 342 F.2d at 308; see also *Booth* v. *Varian Associates, supra,* 334 F.2d at 4; Note, *Put and Call Options Under Section 16 of the Securities Exchange Act,* 69 YALE L. J. 868, 875 (1960) (6 month limitation as to optionees).

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50. Note that even in the foregoing situation the amount of the premium will still not be "assured" profit, since in the event of any increase in the price of the stock the grantor will effectively be deprived of part of the premium received. In addition, Occidental agreed to hold the Kern shares for the term of the option and could not "dump" its shares in the event of a price decline, and thus bore the downside risk also. Here, any decline in the value of the shares would also eradicate the premium pro tanto.

51. See D. VAUGHN, SURVEY OF INVESTMENTS 41 (1967) ("the cost of a six month contract is approximately 12 percent of the market price of the stock"); W. J. EITEMAN, C. A. DICE & D. K. EITEMAN, THE STOCK MARKET 316-17 (4th ed. 1966) ("premiums paid by buyers of six-month calls amount to about 14 percent of the value of the stock. The percentage premium on low-price stocks would probably run somewhat above this, and the percentage premium on high-priced stocks would probably run slightly below"); SEC, REPORT ON PUT AND CALL OPTIONS 84, 85 (1961). (Six-month calls were approximately 12 percent of the current market price; premiums of one-year calls approximately 164.8% of the premiums of six-month calls.)

Whatever hypothetical informational advantage concerning the issuer § 16(b) may attribute to him, the statutory insider remains at the real risk of numerous unpredictable outside factors[52] which have direct impact upon both the value of a security and the willingness of any potential investor (including Tenneco and the LR Fixed Investment Trust) to commit funds to *any* security. Petitioner must in effect argue that 6 months is too short a period to nullify an insider's hypothetical advantage. Nevertheless that is precisely the line the statute draws. *Adler* v. *Klawans, supra,* 267 F.2d at 845. Under § 16(b) all periods of 6 months or more are the same. *Id.*

In *Silverman* v. *Landa, supra,* the court went on to address the very argument petitioner makes here. Plaintiff argued that inside information suggesting that the price of the underlying stock would remain relatively stable would enable the director to insure himself of substantially all of the 16.4% call premium (petitioner's argument here) *and* the 8.2% put premium (a combined 24.6% premium) while retaining his shares at full value. The court held such a theory to be:

> "a proposition *contrary to the statute itself,* which assumes that, after six months, the likelihood of profits from inside information is too remote to warrant continued restriction in the free play of market transactions." 306 F.2d at 425 (Emphasis added).

Thus petitioner's prime "example,"[53] relied upon to support the imposition of liability here (P. Br. 19), prohibits

52. An incomplete sampling of such factors would include the President's health, inflation, recession, wars, peace, international monetary conditions, federal reserve policy, interest rates, government spending, consumer outlays, trade deficits, etc.

53. Petitioner asserts that, when the option first became exercisable *(more than 6 months from the date of grant)*, the market for the Tenneco shares was 93½-95½, and therefore Occidental might

the imposition of liability, because it violates the statutory 6 month rule. In contrast, Judge Friendly's simple and straightforward description of Occidental's risks (14A-15A, 16A) corresponds exactly with the scope of the statute, its underlying assumptions, and governing precedent.

Even this complicated hypothetical abuse, which rests on assumptions contrary to § 16(b), has nothing to do with whether the grantor of an option has recently purchased shares nor with any increase in value which may have occurred since their purchase. Petitioner's argument deliberately confuses a paper increase in the value of the stock as of the date of grant—which, if it exists then, does so whether or not an option is granted and is not realized by the grant—with the effect of the option grant itself. Even if an option grant should turn out to be profitable, the amount of profit attributable to the grant can be no greater than the premium received; thus it has nothing to do with the past purchase price of the stock, and it turns solely on market conditions prevailing *after* the option is granted, not on conditions between the time of a prior purchase of shares and the time of grant. Moreover, the option has the same potential for limited profit or greater possible loss whether the underlying stock has been held for 2 months or 2 years. Indeed the grantor need not even own any stock to write the option. Thus, although petitioner purports to distinguish *Silverman* v. *Landa*, *supra*, on the basis that there was no recent purchase of stock (P. Br.

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have realized only $10.50 per share if it had not *(more than 6 months before)* granted an option at $10 per share (P. Br. 19)—thus arguing from hindsight while violating the statutory limits of presumed foresight. The same erroneous argument is repeated in essence (P. Br. 22) in the assertion that the option "would give it [respondent] a profit of nearly $18 million if the option were exercised, and nearly $9 million even if it were not," which is also inaccurate, since if the merger did not occur Occidental would not even keep the premium, and the underlying investment was exposed to market decline.

16), this is plainly irrelevant under its own theory.[54] See also *Blau* v. *Lamb, supra,* 363 F.2d at 522 n.22.

For the holder, an option "greatly magnifies the opportunity for profit in relation to the amount of the investment," 2 L. Loss, *supra* note 43, at 1077; but for the grantor, the option greatly reduces the opportunity for profit in relation to both the investment and risk assumed. The grant of an option simply bears no resemblance to "the class of transactions in which the possibility of abuse was believed to be intolerably great," see *Reliance Electric Co.* v. *Emerson Electric Co., supra,* 404 U.S. at 422, and to which the statute was "categorically limited," *Silverman* v. *Landa, supra,* 306 F.2d at 425.[55]

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54. Note that although petitioner focuses the whole of its "as a matter of law" argument on receipt of a premium as an alleged instrument of § 16(b) profits, it switches in a footnote (P. Br. 22n.) to the quite different theory that the underlying stock was sold, and claims it is entitled not merely to the premium but to any increment in the value of the underlying stock as of the date of grant, giving no reason, but citing *Bershad* v. *McDonough, supra,* and *Blau* v. *Allen,* 163 F. Supp. 702 (S.D.N.Y. 1958). These cases afford petitioner no support, but hold merely that a sale will not escape liability merely because it is labeled or, as in the *Allen* case, is retroactively alleged to be, an option. In the *Allen* case the sales contract called for a total payment of $22 million with three installments of 2, 10 and 10 million dollars, and *any* payments made were to be treated as "liquidated damages" if final payment were not made, 163 F. Supp. at 705. Both cases involve a plain purchase and sale, all proceeds of which are chargeable.

55. Petitioner also rests heavily on its *ipse dixit* assertions that a statutory insider who writes an option is "far more likely to profit [than] suffer a loss" (P. Br. 14) and that "in the overwhelming number of instances" it will be profitable (P. Br. 21). These assertions are not only irrelevant, since they pay no attention to the scope of § 16(b), they are also bereft of support. The most extensive statistical survey on option trading found no instances of insider grants of options during the entire survey period, REPORT ON PUT AND CALL OPTIONS, *supra* note 51, at 56 (the "REPORT"), and confirmed that option writing appealed primarily to large investors seeking a relatively small current income through the sale of a sufficient number of options to compensate for losses on some and profits on others; see Note, *Put and Call Options under Section 16 of the Securities Exchange Act, supra,* 69 YALE L. J. at 894, which also recog-

Thus the court below correctly applied the "possibility of abuse" test to the grant of an option and correctly found that it was no "sale." It refused to create a fiction that a grant realizes or guarantees profit, to ignore the encumbrance placed upon the grantor, and to disregard the consistent interpretation and scope of the statute. Each of petitioner's attacks on the opinion below suffers from one or more of its own errors.

For example, petitioner argues that it should recover even though the option was reasonably priced, since a reasonable "sale" price would be no defense under § 16(b) (P. Br. 20). This argument simply begs the question by ignoring all differences between the risk-bearing grant of an option and a risk-ending sale of shares, arguing as if a sale had been established under § 16(b).

Petitioner attacks the court's recognition that the premium here would have to be refunded if for any reason the merger did not occur or was delayed, by pointing out that Kern and Tenneco opted to close the merger within 6 months. It *fails to add* that when, if at all, the merger might occur was one *additional* contingency out of Occidental's hands, and that the removal of that contingency merely enabled Occidental to retain the premium, which any other optionor would always have the right to retain, but it created no sale, which still depended upon the future market conditions and the judgment of the optionee, in light of those conditions, whether to call the stock.

Petitioner attacks the court's recognition that the option would undoubtedly lapse unexercised if the market turned sour during the more than 6 to 13 month period before the

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nizes that the grant of an option is not covered by § 16(b). *Id.* at 893-94. The REPORT noted that holders of options, in contrast to grantors, must report under § 16(a). *Compare* REPORT 75 with *id.* 56; see text at pp. 30-32, *supra*. Thus insiders apparently had not availed themselves of this not-very-advantageous opportunity even when they could do so without publicity.

option might first become exercisable (14A)[56] by countering that Occidental would retain the premium (P. Br. 21), but it *fails to add* that Occidental would also incur a multimillion dollar loss precisely because the shares allegedly "sold" had not been sold. Petitioner accepts the court's recognition that the grantor limits the speculative potential of his share ownership but says that a "sale" also limits such potential, *failing to add* that a sale also ends risk, which is precisely what sets it apart from an option. Here Occidental was both prevented from participating in price increases—which did occur during the term of the option[57] —and yet also bore the investment risk.

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56. Judge Friendly noted that the Tenneco preference stock might have a downside risk of $75 per share, which was reasonable in light of the fact that the preference stock had an ultimate equity base of 3.6 shares of Tenneco common stock, which had in the prior nine month period traded as low as 19⅛ and 20⅞ (492a, Ex. A at 6) and the difference between the preferred shares' proposed dividend and the expectable dividend on the related amount of Tenneco's common was just over $1 (*Id.* 5-6). In fact, during the course of this litigation the Tenneco preference shares showed they could drop at least as low as 66½. STANDARD & POOR'S, ISL DAILY STOCK PRICE INDEX, vol. 2 at 328 (1970) (May 26, 27, 1970). Dow Jones Industrial Average was approximately 660, *id.* at ix.

57. On the first trading day after the Kern-Tenneco merger was announced, the Kern shares rose to 94¼, closing at 93. (See 492a, Ex. A at 6.) In June and July, before the merger closing, Kern shares closed as high as 96⅜ (July 12) and as low as 88¼ (June 15). On September 13 Kern shares (still listed for trading) traded as high as 106¾, while the Tenneco common stock also reached a peak of 32¼. Other shareholders could realize this short-term gain, but because of the option Occidental could not, entirely without regard to § 16(b). During November the Tenneco preference stock again dropped and was bid at 92 (Nov. 21) but in the last trading week before the option was exercised rose again to 95-97 (Dec. 5) and, at the close of the day during which the option was exercised, December 11, was quoted at 93½-95½. Sources of quotations: Kern shares: STANDARD & POOR'S, ISL DAILY STOCK PRICE INDEX, vol. 2 at 175; vol. 3 at 176 (1967). Tenneco common stock: *Id.*, vol. 3 at 300. Tenneco Preference Stock: Wall St. J., Nov. 22, 1967, at 29, col. 6; *Id.*, Dec. 6, 1967, at 29, col. 6; *Id.*, Dec. 12, 1967, at 29, col. 6. National Quotation Bureau, Inc. reports that on Sept. 13 Tenneco preferred shares were quoted at 106½-107½ and on Dec. 11 at 94½-96½. During the same period the Dow Jones Industrial Average had advanced from approximately 870 in the June-July period, to 923 on Sept. 13, closing at 881 on the day during which the option was exercised. STANDARD & POOR'S, *supra*, vol. 2 at ix; vol. 3 at ix.

Petitioner's position is based upon the idea that any transaction with an "opportunity to profit [or lose]" is a "sale" (P. Br. 14, 21-22), which is entirely incorrect. Indeed, a purchase standing alone creates such an opportunity, depending on later events. But only a transaction in which the investor *disposes* of his investment is a sale, as the literal language of § 3(a)(14)—"otherwise *dispose* of" —clearly requires, *ejusdem generis,* no matter how broadly read. To achieve the windfall recovery which it seeks without proof of wrongdoing, petitioner must show a conclusive, dispositive act within six months of a purchase of shares. The grant of an option is an inconclusive, nondispositive act, the inherent risks of which are both apparent and judicially recognized, and accordingly has been held to be outside the purpose and scope of § 16(b). Petitioner thus relies in error upon *Gratz* v. *Claughton,* 187 F.2d 46 (2 Cir.), *cert. denied,* 341 U.S. 920 (1951), and *Smolowe* v. *Delendo Corp., supra.* Both cases deal with separate combinations of purchases and sales during the statutory period, not with a single transaction which itself is not a purchase or sale, and which does not end risk but leaves questions of profit and loss to long-term conditions. Both cases set down "thoroughgoing" rules of profit computation *after* purchases and sales are proved, but cannot be used by petitioner as bootstraps to supply the missing elements of liability.

B. There was no basis for finding that the option was a "sale in fact."

Petitioner's claim that the decision below requires "ad hoc" inquiry into an investor's " 'intent' " (P. Br. 23) virtually inverts both the holding below and this Court's decision in the *Reliance* case, since neither decision invites any such inquiry. The court below held that, unless an investor

acquires at least a *right* to dispose of shares within six months of a purchase, § 16(b) has no application. The test under which the court below would impose liability despite the apparent absence of such a right distinguishes between transactions, not "intents," and correctly focuses on the commercial substance of the agreement to determine what in fact was done:

> "When the down payment is so large in relation to the purchase price that exercise is practically compelled or the price is below any reasonable expectation of the value of the security at the end of the option period . . .

then

> . . . a court might find that in truth and fact a sale had occurred when the 'option' was granted." (14A)

This test articulated by Judge Friendly emerged from a full understanding of the factors which led to the result in *Bershad* v. *McDonough, supra.*

In *Bershad* the defendant McDonough (and his wife) bought 282,726 shares of the common stock of Cudahy Corporation ("Cudahy") in the liquidation of the estate of Edward Cudahy at $6.75 per share. As this was a controlling block, McDonough and two associates were elected directors. Within 4 months McDonough entered into a so-called "option" with "Smelting" covering 272,000 shares at $9 each, pursuant to which he received $350,000, which was not returnable in any event and would be credited against a total sale price of $2,448,000. The "option" had to be exercised or would expire just over 2 months after grant. At the same time McDonough gave Smelting an irrevocable proxy to vote the shares for that 2 month period. Within two days he and his associates resigned from the board, and three days later the positions were filled by nominees of the buyer, thus passing immediate control. Plaintiff attacked

the agreement, claiming that it was "more than" an option, 300 F. Supp. at 1054. On its motion for summary judgment the district court so found. It was affirmed on the ground that:

> "The circumstances of the transactions clearly indicate that the stock was effectively transferred, for all practical purposes, long before the exercise of the option." 428 F.2d at 698,

the court of appeals stressing that its objective was to expose the "commercial substance" of "sham transactions," *id.* 697. The district court in *Bershad* had noted that "unlike the situation in *Silverman* v. *Landa, supra,* the money paid to the McDonoughs was not a premium," 300 F. Supp. at 1054, and the court of appeals viewed the amount paid as a "significant deterrent to the abandonment of the contemplated sale," 428 F.2d at 698, thus indicating that there was no option in fact involved in that case.

In an option the premium paid does not act as a "deterrent" to nonexercise. Rather it is the option's exercise price which determines exercise in future market conditions. If the effective exercise price of an option is $95, the optionee will decide whether or not to exercise it based upon the desirability of a purchase at $95 in economic conditions prevailing when the option is exercisable, without regard to whether he has previously paid $3 or $20 for the privilege to buy at $95. If, however, the effective exercise price is set significantly below the current market value at the time the option is granted, then the economic balance is radically shifted toward exercise, and it is no longer a true option. That a premium is made creditable against a stated price upon exercise is a matter of form. It merely means that the stated price must be reduced by the amount of the premium in order to determine whether the real exercise price is in reasonable range of current market, or is

well below market and is thus designed to make ultimate sale an economic certainty—a case where, as Judge Friendly stated, the "payment is so large in relation to the purchase price that exercise is practically compelled" (14A). This was exactly the case in *Bershad* v. *McDonough, supra.*

At the time the *Bershad* "option" was granted, Cudahy common closed at 9⅛ on the New York Stock Exchange.[58] The stated option price of $9 per share was itself below market, and because the initial payment of $1.25 per share was creditable against the stated price, the effective exercise price of the so-called "option" was $7.75 per share, substantially (over 15%) below current market. The "commercial substance" was that the alleged optionee had to buy the stock even if, in the *short-term* period after grant, it fell significantly below the market price prevailing at the time of grant. The alleged "optionor" thus had "practically compelled" a sale, creating the economic assurance of a sale in place of the contractual right § 16(b) requires. Smelting had not paid a premium but had made a down payment by purchasing part of the stock's current market value, as the plaintiff there expressly pointed out.[59]

Because the economics of the *Bershad* agreement showed it was not an option in fact, the defendant made no attempt to defend its terms. At oral argument before the Seventh Circuit he first produced a letter purporting to show that

58. Wall St. J., July 21, 1967, at 20, col. 2.

59. Plaintiff in *Bershad* stressed that in *Silverman* the premium was paid "for an option to purchase the stock at the full market value on the date the option was granted. * * * McDonough wanted to make sure that he had the equivalent of a firm sale and did so by asking for the substantial down payment." Memorandum of Law in Opposition to Defendant McDonough's Motion for Summary Judgment and in Support of Plaintiff's Cross-Motion for Summary Judgment, 7-8, 300 F. Supp. 1051 (N.D. Ill. 1969).

the alleged "premium" was reasonable.[60] Plaintiff correctly responded that the size of the premium was not the relevant factor because "the $350,000 was a discount from market price unlike the normal procedure in which the payment for the true option is a premium above the market price."[61] Taking this feature, together with the transfer of virtually all incidents of stock ownership, and the short term of the option itself, the court could clearly find that the stock had in fact been sold. The ground for so finding had been ceded to the *Bershad* court, because McDonough could neither defend the agreement nor advise the court of the functions and risks of true options, because to do so would hurt his case. The case lies precisely within Judge Friendly's test, concerned only a disguised sale, and involved no expansion of § 16(b).

In order for the option here to bear any resemblance to the *Bershad* arrangement, it would have been necessary that the option provide for an effective exercise price of less than $82, an initial payment of over $13 (non-returnable), and a term of 2 months.[62] There is no economic resemblance between the two agreements. The effective exercise price of the option was $95. This was not below current market. The Kern shares were then already trading at prices reflecting the Kern Board's acceptance of the proposed

60. Petition for Rehearing 9. No contemporaneous advice had been sought, and the belated proof was offered as a post facto justification.

61. Answer to Petition for Rehearing 9.

62. Thus, petitioner's assertion that a statutory insider can "fix" the prices of an option (P. Br. 19) is essentially irrelevant, since the question under § 16(b) is not what hypothetical transaction he *could* make, but what transaction he *did* in fact make. Moreover, § 16(b) does not presume that an insider can "fix" the prices of transactions with others, but rather that he can take unfair advantage of existing or future market prices fixed by others. Obviously, even a statutory insider cannot freely fix such prices since he is limited by what the market or bargaining will bear.

exchange for Tenneco preference shares and had reached no higher than 94¾ (492a, Ex. 1 at 6). The returnable premium itself was based on expert advice and comports with published values of premiums (which are not returnable). And setting the premium against Lehman Brothers' projection of what the stock might fairly be worth reflected a reasonable expectation of possible price change, neither guaranteeing exercise nor seeking advantage. It was by no means certain that the market price of the Tenneco preference shares at the distant period when the option might be exercisable would not be well below $95. The option was not short term, unlike the arrangement in *Bershad,* but was exercisable only more than six months from both Occidental's most recent purchase of shares *and* the time of its grant and might become exercisable as late as 13 months after its grant. At such times no one can be held under § 16(b) to predict whether the market would favor, or even permit, exercise by the optionee.

The regulations adopted by the Board of Governors of the Federal Reserve System pursuant to § 23 of the Act, see 35 Fed. Reg. 3280 (1970), to prevent abuses of investment borrowing rules, point out the essential distinction between the spurious "option" in the *Bershad* case and the option here, under the same analysis employed by Judge Friendly. Addressing a so-called "deep in the money" agreement, where the initial payment represents a substantial discount from the stock's current market price, rather than a premium above it, the rule states:

> "(c) The option embodied in the normal put or call is exercisable either at the market price of the security at the time the option is written or some 'points away' from the market. The price of a normal option is modest by comparison with the margin required to take a position.
>
> • • • • •

> (f) Turning to the 'deep in the money' [call option] . . . even if the price fell, unlike the situation with a normal option, the buyer would still be virtually certain to exercise his right to purchase before it expired in order to minimize his loss. The result would be that the buyer would not have a genuine choice whether or not to buy. . . ." 12 C.F.R. § 220.122 (1972).[63]

Petitioner's sole objection here is an isolated post-appellate attack on the amount of the premium, but it does not dispute that Davis called the Donaldson firm and was advised that a reasonable premium would be $9 to $12 per share. It merely seeks remand as an afterthought following the decision below to search for an "expert" who might be willing to testify that if he had been retained then he would have approved of a lower premium. Since the amount of the premium has been an integral part of petitioner's case since the district court,[64] and since it did not there or in the court of appeals dispute Occidental's responsive proof as to the basis and origin of the premium,[65] this offer comes too late.[66]

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63. The example under discussion was a 30 day "option" on a stock then selling at $100 to buy it at $70 where the buyer initially paid 30 percent of the stock's market price to the grantor.

64. Brief for Appellee 56; Memorandum of [New Kern] In Support of Its Motion for Summary Judgment in 67 Civ. 4042 (May 7, 1970), at 39.

65. In the district court petitioner both had and exercised an opportunity to dispute Occidental's recital of the record. It submitted reply affidavits disputing only those facts relating to the question of whether Tenneco had agreed to delay the closing of the merger and the circumstances surrounding its closing in violation of the outstanding court order (249a-250a), leaving undisputed in the record both the basis and reasonableness of the premium.

66. Indeed, the proper time to have come forward with other views of a fair premium was at the time the option was negotiated.

Equally important, petitioner's attack on the size of the premium in isolation has no bearing on the § 16(b) issue, as the plaintiff in the *Bershad* case correctly noted, since it did not represent a discount on the current market price. Petitioner appears to argue that, even though any other shareholder could have sold an option at $10 per share (and on better terms), Occidental was required by § 16(b) to take less because of the number of shares subject to the option.[67] The aim of the statute is not that a large shareholder take less, but only that he does not take unfair advantage of inside information. Any person can grant an option and obtain a premium, and because only general knowledge of opportunities available in the market place, not inside information, is necessary to do so, it raises no § 16(b) problem. See *Falco* v. *Donner Foundation, Inc., supra,* 208 F.2d at 604. Section 16(b) is not activated by the grant of an option, and an option exercisable more than 6 months from the date of grant could not in any event be included under the statute. Thus, if the premium alone is alleged to be unfair, which petitioner has denied, the action lies not under § 16(b) but under some other theory of recovery:

> "[S]peculation actual or potential is the only vice within the purview of § 16(b). Other possible abuses of options do not now concern us." *Blau* v. *Ogsbury, supra,* 210 F.2d at 427.[68]

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when an adjustment, if any, would have been a relatively small amount in the premium, not when the stakes have changed to a multimillion dollar claim for § 16(b) damages.

67. This makes little sense. Although a buyer may pay slightly more or less than the current market value for a block of shares at any given time, depending upon whether he finds the block an advantage or disadvantage in economic conditions existing at that time, there is no reason why a potential increase in the price of shares (which is the fair measure of a premium) does not command full value.

68. The analogue of petitioner's argument would be that a purchase and sale separated by more than 6 months is subject to §16(b) if the purchase price were "too low" or the sale price "too high." If there is a cause of action, it is clearly not within § 16(b).

The option here had more than the usual range of contingencies in addition to its long term. Its holder was even less "committed," if at all, to its exercise than the usual optionee. Occidental's right to keep the premium depended not merely upon the merger but upon its consummation before July 31, 1968. If Kern and Tenneco found it undesirable to merge or were forced to delay for any reason, Occidental would have to return the premium.[69] Since the value of the Kern shares had been inflated by merger prospects, Occidental faced the extraordinary risk of a 30% price decline to their pre-merger level if no merger occurred. Nor may it be said that Occidental could then resume its own bid, since that decision would depend upon the future state of the market and financial condition of both Occidental and Kern.

If and when the merger took place was similarly beyond Occidental's control. And after the merger took place Occidental was entitled to retain the premium; thus for the first time it had a reasonable option agreement, but it remained at the risk of the market and at the pleasure of the optionee. Occidental could not take advantage of any short-term increases in the value of Kern or Tenneco shares, which would inure to other shareholders. On the other hand, Occidental fully bore the risk of future market declines, since it could not dispose of its shares during a 6 and prospectively 14 month period.

The facts of this case present another barrier to the application of § 16(b). The statute in terms requires a purchase and sale of shares of the same issuer, but here the option was not granted on the Kern shares but on then nonexistent and unregistered Tenneco shares which Occidental might receive if there were a merger. A claim that Occidental

69. Indeed, under the omnibus clause in the Plan (124a, Ex. D, D24) Kern and Tenneco could delay the merger merely to cause Occidental to repay the premium, although it would not redound to their benefit, since Tenneco Corporation had already sold the option.

can be held under § 16(b) to foretell the *future* market price of the shares subject to the option after it became exercisable requires an inside relationship, statutorily defined, to the issuer of *those* shares.

Thus, even assuming the merger were consummated, the exercise of the option (and profit or loss thereon) turned not on the value of Kern's shares but on the future market value of the Tenneco preference shares. Occidental cannot be held liable on the basis of a *long-term* projection as to the business affairs of a corporation of which it was *not* a statutory insider, about which it cannot be presumed to have had inside information,[70] and on the basis of shareholdings *not* subject to § 16.

Against these long-term risks petitioner amasses an array of irrelevant factors, including the charge that the option agreement was entered to avoid triggering § 16(b). Under § 16(b) it is irrelevant what Occidental may previously have wanted. The question is what it did. *Reliance Electric Co.* v. *Emerson Electric Co., supra,* 404 U.S. at 422. What Occidental did not do is sell its shares.[71]

The other factors which are said to align this case with *Bershad* are not comparable individually, collectively or in context. Occidental did not transfer directorships or control because it was a locked-in disempowered shareholder

70. At the time of the grant of the option Occidental was in no way the "beneficial owner" of then nonexistent Tenneco preference stock which, in addition, was not subject to § 16, and was not convertible into registered Tenneco common stock during the relevant period. No right to the preference shares could accrue until after the merger was approved and all conditions precedent were met. Even when such a right exists, the existence of a right to receive shares in a merger at a future date does not constitute beneficial ownership of such shares for purposes of § 16. Rule X-16a-6a(3), 37 Fed. Reg. 4329 (1972).

71. Petitioner suggests that the option served "none of the economic functions" of an option (P. Br. 24), which is incorrect. It functioned entirely as an option, although the *reasons* for its grant were motivated by respect for the existence of the statute.

and had neither. Occidental's dismissal of the shareholder suits, which petitioner's counsel characterized as "simply proceedings for the inspection of books and records" (112a), was not in consideration for the option, but for the "harmless" favor (Symonds depos. 91) of a brief delay in the registration of the proposed Tenneco stock. Dropping a demand for two directorships where possession of such directorships was nonexistent and not forthcoming is simply of no substance.

Petitioner presses the allegation, first made after the decision below, that Occidental gave its own attorney (Mr. Brown) a revocable proxy, and that Mr. Brown told Mr. Daum he would vote Occidental's shares in favor of the merger, claiming that this should upset the decision below.[72] Petitioner's version of these circumstances has changed since first expressed in its Petition for Rehearing. There petitioner allowed that Occidental "was unwilling to make the proxy a condition of the option agreement" (510a) but has deleted that from its presentation here. Similarly deleted is the claim that the proxy was "intended to be irrevocable," *id.*, which was an attempt to convert it into the irrevocable proxy in *Bershad*, which, in addition, was not a proxy of limited purpose but gave general corporate power. The facts are that Mr. Symonds did not bargain for nor did he know of any discussion of how Occidental might vote its shares (60a); Tenneco conceded that the option was not conditioned upon Occidental's neutrality or support (366a); and Occidental did not vote for the merger (81a). Even

72. Here again petitioner's failure to press any such claim in the two courts through which it has passed cannot be excused. Petitioner's attempt to attribute this to a lack of discovery (P. Br. 7n.) is absurd. It had no need to discover facts of which its own counsel claims to have had personal knowledge; Occidental's revocable proxy to its own attorney was in fact elicited in discovery (Davis depos. 41, 79), and petitioner's failure previously to mention any proxy merely indicates its own prior and correct view that the matter was of no importance (82a).

wholly crediting petitioner's latest version *arguendo,* the revocable proxy was revoked and exchanged merely for a letter which fairly explained why Occidental had decided not to oppose the merger pointlessly.

These new claims have no significance, since the necessary bases for liability under § 16(b) were wholly lacking here. In *Bershad* the court was confronted with a short-term spurious "option" which practically compelled a sale. The concurrent passage of actual control[73] strongly reinforced a basic case of liability, and it was only upon such an unusual combination of factors that the court predicated liability. 428 F.2d at 698. But the fundamental fact of the instant case is that every act undertaken by Kern's management, and successfully so, had the specific purpose of nullifying the attributes usually ascribed to the share ownership which Occidental had acquired. Yet it is on the success of that very strategy that petitioner would impose liability. Petitioner's belated offer of proof, if credited, could only show that the proposed merger did not face senseless opposition by Occidental, and its contention makes the result turn on whether Occidental had instead manufactured actual or symbolic obstacles to the merger.

Petitioner's attempt to divert attention from the long-term risks of the option is belied by its own statement to shareholders, while the option was outstanding, that it was uncertain whether it would exercise it even if the merger occurred (492a, Ex. 1, at 3). The refusal of the court below to be drawn into an inquiry which was not merely "ad hoc" but irrelevant was entirely correct.

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73. In *Bershad* the value of McDonough's shares lay in their capacity to transfer control to Smelting, 300 F. Supp. at 1055, and the passage of that control—virtually all the incidents of ownership—with the option agreement was explainable only on grounds that the stock had in effect been sold. Here Occidental could not give Tenneco control of Kern; but Kern could, and it had effectively done so entirely without regard to Occidental before any discussions between Tenneco and Occidental ever occurred.

POINT II

Kern's and Tenneco's merger was not Occidental's sale.

The initial question presented here is whether a hostile corporation and its chosen merger partner may cause a merger and then extract a windfall recovery by labeling their own acts a "sale" by respondent, even though respondent did not sell or exchange any shares within 6 months of purchase as § 16(b) requires.

Here the Court need not reach the inquiry made in the "pragmatic" cases, for in all such cases the defendant either exchanged shares, by exercising an option to convert or otherwise, or controlled the exchange.[74] His exchange of shares arguably triggered the statute, and this in turn called for a "possibility of abuse" inquiry. Compare *Petteys* v. *Butler, supra,* 367 F.2d at 537. But in this case the elements of liability prescribed by the statute are lacking. We also show herein that the event alleged to be a sale gave no opportunity for the unfair use of inside information under the "possibility of abuse" test. Both approaches yield the same result.

Petitioner specifies no act of "sale" by Occidental. Its recital of the "facts underlying the exchange" (P. Br. 26) consists solely of an account of Kern and Tenneco carrying

74. *Newmark* v. *RKO General, Inc., supra,* 425 F.2d 348; *Petteys* v. *Butler, supra,* 367 F.2d 528; *Blau* v. *Lamb, supra,* 363 F.2d 507; *Blau* v. *Max Factor & Co., supra,* 342 F.2d 304; *Ferraiolo* v. *Newman, supra,* 259 F.2d 342; *Gold* v. *Scurlock,* 324 F. Supp. 1211 (E.D. Va. 1971), *appeal pending,* No. 71-2180-82, 4 Cir; see text at note 107, *infra.* Note that in conversion cases the investor always carries out a deliberate exchange, thus arguably triggering the Act. The inquiry in such cases focuses upon whether the conversion was "forced" by a call for redemption beyond the investor's control, and even if not so forced, whether the exchange causes a relevant change in the investor's equity investment. See *Blau* v. *Lamb, supra,* 363 F.2d at 518n.15.

out a merger. It goes on to say that, "[a]side from differing income tax consequences," the "net effect" is just as if Occidental sold Kern stock and bought Tenneco stock (P. Br. 27)—transactions that never occurred. It should have said "aside from differing §16(b) consequences," since §16(b) is not concerned with the "net effects" of others' acts but with specific acts by specified persons that trigger liability in a mechanical fashion. "[I]t can hardly be said that failure to sell is tantamount to a purchase"—even though the "net effect" is just the same as a sale and repurchase. *Ferraiolo* v. *Newman, supra,* 259 F.2d at 346.

Petitioner conceded below that Occidental had no alternative to accepting the results of Kern's and Tenneco's merger:

> "It is true that the transaction was so cast that, once approved, defendant had no alternative, such as appraisal rights, to accepting its results. Further, defendant's over 20% ownership of Old Kern would not, of itself, have sufficed to secure or prevent approval of the exchange." [75]

Since the merger was not controlled or engineered by Occidental; since it could not block the merger, which was compelled by the overwhelming vote of Tenneco and Kern shareholders; since whether and when the merger would occur lay with Tenneco and Kern; and since Occidental's investment was altered merely by the operation of California law, there is no basis for calling the merger of Kern and Tenneco a "sale by Occidental." No issue under §16(b) arises, and the Court need go no further.

No authority cited by petitioner meets this issue with the single exception of *Shaw* v. *Dreyfus, supra,* which supports respondent and states that §16(b) "purchases" and "sales"

75. Memorandum of [New Kern] in Support of Its Motion for Summary Judgment in 67 Civ. 4042 (May 7, 1970) at 25-26.

are transactions occurring "by one's own act." 172 F.2d at 142.[76] It has no colorable support even in the reputedly strict dictum of *Park & Tilford, Inc.* v. *Schulte, supra,* since Judge Clark there made plain that he was considering only an exchange made in fact by the defendants, and which was entirely subject to the defendants' control,[77] and he later expressly reemphasized both these qualifications. *Roberts* v. *Eaton, supra,* 212 F.2d at 83, 85.

Likewise the cases arising under § 10 of the Act, relied on by respondent, instead support Occidental.[78] They hold that where a shareholder's investment is altered in a merger, the choiceless nature of the transaction may not be turned *against him* by those who procure the merger. Here those who procured the merger seek to turn it against Occidental. Moreover, §16(b)'s definitional problems cannot be solved by such cases, which "involved different facts and different statutes, statutes which themselves have different language, purposes, and history from the statute here." See *Blau* v. *Lehman, supra,* 368 U.S. at 411 n.11.[79]

In view of §16(b)'s purpose it might be argued that the exchange could yet be attributed to Occidental if it knew

76. See also *Ferraiolo* v. *Newman, supra,* 259 F.2d at 344-45 nn. 2 & 3.

77. "Defendants did not own the common stock in question before *they exercised their option to convert;* they did afterward. Therefore they acquired the stock within the meaning of the Act. . . . [T]he contention that defendants were forced to convert is somewhat *absurd* in view of the fact that . . . defendants *controlled plaintiff.* . . ." *Park & Tilford, Inc.* v. *Schulte, supra,* 160 F.2d at 987, 988 (Emphasis added).

78. *SEC* v. *National Securities, Inc.,* 393 U.S. 453 (1969); *Dasho* v. *Susquehanna Corp.,* 380 F.2d 262 (7 Cir.), *cert. denied,* 389 U.S. 977 (1967) (exchange by corporation); *Vine* v. *Beneficial Finance Co., Inc.,* 374 F.2d 627 (2 Cir.), *cert. denied,* 389 U.S. 970 (1967) (P. Br. 28).

79. See also *SEC* v. *National Securities, Inc., supra,* 393 U.S. at 466; *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Industries, Inc.,* 309 F. Supp. 75, 80-81 (E.D. Wis. 1970); *Emerson Electric Co.* v. *Reliance Electric Co., supra,* 306 F. Supp. at 591; See text at note 33, *supra.*

of the Kern-Tenneco merger when it offered to buy shares, although that would appear to be a §10 problem. But the Kern-Tenneco negotiations did not even begin until after Occidental was irrevocably committed to accept tenders, and that line of argument is eliminated. No one could know of a merger plan that did not exist. There has been no case which has imposed liability where the defendant did not control or have a realistic alternative to the alleged § 16(b) event.[80]

The same result follows under the "possibility of abuse" test, where the choiceless nature of the transaction is also relevant. This test has been adopted by every circuit, with the possible exception of one purely voluntary conversion case,[81] that has considered these issues and holds that an exchange is only a "purchase" or "sale" if it permitted an

80. See *Newmark* v. *RKO General, Inc., supra,* 425 F.2d at 353; *Blau* v. *Lamb, supra,* 363 F.2d at 518-20 nn.15 & 16; *Petteys* v. *Butler, supra,* 367 F.2d at 530; *Heli-Coil Corp.* v. *Webster,* 352 F.2d 156 (3 Cir. 1965) (no call for redemption); *Blau* v. *Lehman, supra,* 286 F.2d at 792; *Ferraiolo* v. *Newman, supra,* 259 F.2d at 346; *Park & Tilford, Inc.* v. *Schulte, supra,* 160 F.2d at 987-8; *Gold* v. *Scurlock, supra* (principal stockholders and directors of merging corporation with options not to participate in merger); *Lynam* v. *Livingston,* 276 F. Supp. 104, 106, 107 (D. Del. 1967); *Marquette Cement Mfg. Co.* v. *Andreas,* 239 F. Supp. 962, 966 (S.D.N.Y. 1965); *Blau* v. *Hodgkinson,* 100 F. Supp. 361 (S.D.N.Y. 1951) (option not to take stock on "purchase" side); *cf. Alloys Unlimited, Inc.* v. *Gilbert,* 319 F. Supp. 617, 619 (S.D.N.Y. 1970). See also *Booth* v. *Varian Associates, supra,* 334 F.2d at 5 (active directors); *Roberts* v. *Eaton, supra,* 212 F.2d at 83-84; *Blau* v. *Oppenheim,* 250 F. Supp. 881, 885 (S.D.N.Y. 1966); *Perlman* v. *Timberlake,* 172 F. Supp. 246, 256 (S.D.N.Y. 1959).

81. The Third Circuit, in a three-way split decision, found that a voluntary conversion was a "sale" but would not impose liability, holding that defendant's profits were not "realized" unless he sold for cash. *Heli-Coil Corp.* v. *Webster, supra,* 352 F.2d at 167-68. This rule has been construed in the same circuit not to create a purchase or sale where the conversion was "forced" by a call for redemption which defendant did not control. *Lynam* v. *Livingston, supra,* 276 F. Supp. at 107.

insider to obtain an advantage through the unfair use of inside information. *Blau* v. *Lamb, supra,* 363 F.2d at 516.[82] The standard in a merger case was articulated in *Newmark* v. *RKO General, Inc., supra,* 425 F.2d at 351:

> "The complexities of the commercial and financial world, however, have defied the draftsmen's efforts at neat classification. Whether certain 'unorthodox' transactions, well illustrated here by the exchanges of securities incident to a merger which form the basis of this appeal, are 'purchases' or 'sales' for the purposes of Section 16(b) cannot be resolved by mere reference to the words of the statute. In such cases, the determination of the statute's relevance must rest, initially, on whether there exists the potential for evil against which the statute was intended to guard."

In *Newmark* defendant "RKO" acquired the right to buy a controlling block of shares of the issuer corporation ("Central"), having first negotiated a secret agreement to merge it with "Frontier," an RKO subsidiary. Under the agreement Central would be managed in RKO's interest until the proposed merger. Not only could RKO purchase the Central shares knowing that it would exchange them in the merger, it also had complete control over "when or, for that matter, if the purchase and merger would take place," *id.* 353, and thus could choose to buy knowing it could sell advantageously or could abandon both parts of the transaction if it appeared unprofitable. Here the circumstances were opposite in all respects.

During a 4 day period in May 1967 Occidental, operating exclusively on public information, made two irrevocable offers for a total of a million shares of Kern stock at a price

82. See cases cited at note 74, *supra.*

30% above the market.[83] In contrast to RKO's private purchase Occidental made a firm commitment in the spotlight of a nationally publicized tender offer equally available to any Kern shareholder. Occidental was already irrevocably obligated to accept tenders[84] before Kern and Tenneco began the negotiations of May 15th which first resulted in an offer on May 18th.[85] Kern's incumbents successfully attracted a "defensive" merger partner and immediately accepted its terms, which were substantially richer than Occidental's own offer. The Kern-Tenneco merger was designed to *prevent* Occidental from controlling *anything* Kern did, and it was completely successful. If Occidental had any control over that merger, it is obvious that it would not have occurred within six months. Occidental's only choice was first to outbid Tenneco's tax-free offer and then to wage a proxy fight, while systematically opposed by Tenneco and Kern's hostile management, merely to prevent *them* from "disposing" of *its* shares in the short term, and this was no "choice" at all. No one has suggested how the alleged "disposition" might have been avoided. Compare *Alloys Unlimited, Inc.* v. *Gilbert,* 319 F. Supp. 617, 619

83. The high purchase premium alone negates speculative abuse, for it strains reason that an outsider would pay so high a price on a gamble that it would later learn inside information which would not only justify the price previously paid but also yield a quick profit. The court of appeals noted that there is "not a word in the record" to indicate Occidental had any nonpublic information concerning the value of Kern stock in making its offers (11A n.12).

84. *Cf. Radiation Dynamics, Inc.* v. *Goldmuntz,* CCH Fed. Sec. L. Rep. ¶ 93,548, — F. 2d — (2 Cir. 1972). (A party cannot "use material inside information unfairly when he fulfills contractual commitments which were incurred by him previous to his acquisition of that information.")

85. Petitioner noted that "the original negotiations of the Tenneco-Kern agreement took place during a period commencing May 15, 1967" (114a). Old Kern's president testified that on May 15 he "first learned" that Tenneco might be interested in exploring the possibility of making an offer (61a).

(S.D.N.Y. 1970). The merger exchange was pro rata, and all shareholders including Occidental received whatever advantages or disadvantages inhered in the terms set by Kern and Tenneco.

Even assuming *arguendo* that Occidental actually had and used inside information in determining *not* to fight the merger, this has no § 16(b) significance. Not only was the financial condition of Kern (and Tenneco) exhaustively set forth in the proxy statement, giving all shareholders an equal opportunity to assess the merits of the Plan, allowing for no insiders' advantage, see *Roberts* v. *Eaton, supra,* 212 F.2d at 85, but also the only possible result of an informed decision by Occidental would merely be that it would incur the same benefits or detriments shared by all Kern shareholders.[86] Because the transmutation of shares in the merger was on a pro rata basis, Occidental could not obtain any special insider's profit.[87] It neither bought

86. Petitioner repeatedly stresses its view that after the proposed merger was announced Occidental's exercise of its statutory right of inspection, available to all shareholders, gave Occidental "inside" information, although the record indicates that Kern's disclosure was grudging and minimal. As shown above, even possession of inside information at this stage in the sequence of events has no § 16(b) consequence. We also note that only the first 7 pages of the 134 page proxy statement have been reproduced in the Appendix here, although the entire statement is in the Record of the case. The shareholder vote on the Plan leaves no doubt as to its appeal.

87. See *Blau* v. *Max Factor & Co., supra,* 342 F.2d at 308; *Petteys* v. *Butler, supra,* 367 F.2d at 537; *Ferraiolo* v. *Newman, supra,* 259 F.2d at 346; *Roberts* v. *Eaton, supra,* 212 F.2d at 85 ("like treatment of all stockholders will in most cases remove the possibility of abuse"). See also *Shaw* v. *Dreyfus, supra;* compare *Marquette Cement Mfg. Co.* v. *Andreas, supra,* 239 F. Supp. at 966. The question of whether a merger exchange constitutes a "purchase" involves different considerations; compare *Gold* v. *Scurlock, supra; Marquette Cement Mfg. Co.* v. *Andreas, supra;* and *Blau* v. *Hodgkinson, supra* (P. Br. 28). When shareholders "purchase" stock in the surviving corporation in a merger they may acquire a trading advantage over other shareholders of that issuer because the exchange is not pro rata as to all of its shareholders. Moreover the defendants in these cases "purchased" voluntarily in that they could readily avoid participation in the merger. See notes 74 and 80, *supra.*

in a manner permitting abuse of information, nor could it get "out" at a more advantageous price or time. See *Newmark* v. *RKO General, Inc., supra,* 425 F.2d at 356.

Therefore the merger could not possibly serve as a vehicle for the abuses at which § 16(b) was aimed. *Blau* v. *Lamb, supra,* 363 F.2d at 516. From a *purchase* and *sale* in combination the statute presumes "that the [insider] intended, at the time he bought, to get out on a short swing."[88] But no presumption attaches to a purchase alone. A later-conceived pro rata exchange executed by others cannot substitute for an individually timed sale, for cash or other value, in the statutory scheme.[89]

These are not new considerations. In 1934, for example, a commentator stated flatly that a corporate liquidation like Kern's would not be a § 16(b) "sale" by shareholders:

> "[T]he individual stockholder has no freedom of action as to whether or not to surrender his stock certificate, in contrast to the case of a true exchange which is a voluntary act on the part of the seller." Seligman, *Problems under the Securities Exchange Act,* 21 VA. L. REV. 1, 22 (1934).

The district court in the *Reliance Electric* case said expressly that such a share exchange could not be treated as if it were a voluntary cash sale:

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88. *Hearings on S. Res.* 84 & S. *Res.* 56 & *S. Res.* 97 *Before the Senate Committee on Banking and Currency,* 73rd Cong., 1st Sess. 6556-57 (1934). The words are those of Thomas G. Corcoran, Esq.

89. This case is not about an individually negotiated and separately timed "exchange of shares" for other consideration, cash, stock, or otherwise. Thus, *Magida* v. *Continental Can Co.,* 261 F.2d 843 (2 Cir.), *cert. denied,* 351 U.S. 972 (1956), and *Blau* v. *Mission Corp.,* 212 F.2d 77 (2 Cir.), *cert. denied,* 347 U.S. 1016 (1954), relied upon by petitioner, (P. Br. 26-27) are irrelevant. See also *Blau* v. *Lamb, supra,* 242 F. Supp. 151, 155 (S.D.N.Y. 1965), *rev'd on other grounds,* 363 F.2d 507 (2 Cir. 1966), *cert. denied,* 385 U.S. 1002 (1967); *Fistel* v. *Christman,* 135 F. Supp. 830 (S.D.N.Y. 1955).

"Inasmuch as such a transaction is an 'otherwise dispose of' situation, and not a typical or conventional sale, the rationale of *Petteys* [v. *Butler*], supra, would undoubtedly require an examination of the 'unique' facts of the case to determine whether the purposes of Section 16(b) would be furthered by attaching the artificial label of 'sale' to this type of situation."[90]

The precise problem posed here was anticipated in commentary before the decision below:

"One special situation remains to be considered in which such an interpretation may lead to harsh results . . . where no merger was contemplated by the disappearing corporation at the time of the original purchase. Such a situation exists where corporation X seeks to acquire control of corporation Y and through a tender offer purchases enough Y shares to make it a 'beneficial owner' for purposes of section 16(b), but not enough to enable it to control Y. Corporation Y, however, does not wish to be taken over by X and to avoid this result enters into a merger with a third corporation Z. . . . Since the plan to merge was conceived only after the original purchase by corporation X, it cannot possibly have had advance knowledge of the Y-Z merger.

"Since the only reason for treating the exchange of A as a 'sale' is to deter short-swing speculation in anticipation of merger, the rationale of the subjective [i.e., "pragmatic"] test requires that a defend-

90. *Emerson Electric Co.* v. *Reliance Electric Co.*, 306 F. Supp. 588, 591 (E.D. Mo. 1969), *rev'd on other grounds*, 434 F.2d 918 (8 Cir. 1970), *aff'd*, 404 U.S. 418 (1972). The district court was thus unwilling to view the merger as a "sale," even though the defendant Emerson's tender offer was structured to give it the option not to accept any of the shares tendered, and the proposed Reliance-Dodge merger had been announced before Emerson exercised its option to purchase the tendered shares.

> ant be permitted to show that no merger was contemplated at the time of the initial purchase."[91]

The court below similarly concluded that such a merger could not be used for the trading practices which § 16(b) was designed to prevent:

> "[T]he question is whether the receipt of securities of another company, in a transaction which the 'insider' did not arrange and in which all stockholders were entitled, indeed here were forced to participate, constitutes a 'sale.' (10A).
>
> • • • • •
>
> "Occidental had no knowledge what Old Kern would do, and certainly did not know that Old Kern would be able to arrange an exchange offer exceeding Occidental's bid by $20 per share, with the added benefit of freedom from capital gains tax. We fail to see the possibility of speculative abuse in a situation where such an offeror simply declines to make a still higher offer or to attempt to block a transaction which it regards as advantageous to all the stockholders including itself." (12A) (footnote omitted).

Other critical commentators both before and after the decision below have approved the result here.[92]

Thus petitioner's position has no support. The supplemental opinion of the district court in *American Standard*,

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91. Note, *Stock Exchanges Pursuant to Corporate Consolidation: A Section 16(b) "Purchase or Sale"?*, 117 U. PA. L. REV. 1034, 1056-57 (1969) (footnote omitted).

92. Note, *Reliance Electric and 16(b) Litigation: A Return to the Objective Approach?*, *supra* note 33, at 911; Gadsby & Treadway, *Recent Developments Under Section 16(b) of the Securities Exchange Act of 1934*, 17 N.Y.L. FORUM 687, 722 (1971); Note, *The "Pragmatic" Approach to Section 16(b)—Abrams v. Occidental Petroleum Corp.*, 38 BROOKLYN L. REV. 1235 (1972); Comment, *Securities Regulation—Exchange of Stock Pursuant to Merger is "Sale" by an Insider Under Section 16(b) of the Securities Exchange Act of 1934*, 84 HARV. L. REV. 1012, 1021-22 & n.30 (1971).

Inc. v. *Crane Co.*,[93] a case upon which petitioner had relied, clarifies the facts of that case and indicates that the defendant there sold its shares for *cash* within six months of its purchase. This clarification renders the court's previous language regarding merger exchanges mere surplusage. CCH Fed. Sec. L. Rep. ¶ 93,551 (S.D.N.Y. July 6, 1972).

Rather than deterring abuses, petitioner's approach would inspire an entire range of new abuses. This too was the subject of a recent commentary:

> "In other words, . . . not only did A [Occidental] fail in its attempt to take over B [Kern], but B [Kern] (or successor C [Tenneco]) was able to penalize A [Occidental] for the attempt. This will be true in any case in which B [Kern] can arrange for a takeover by C [Tenneco] within six months of A's [Occidental's] purchase of B's [Kern's] stock. B[Kern] thus forces A [Occidental] into a section 16(b) 'sale' from which B [Kern] recovers the 'profit' . . . . Such a use of the securities laws seems unwarranted, ... In terms of fairness, where an individual subject to section 16(b), but obviously not in control, is forced or obligated to transform his investment into shares of a successor corporation, the purpose of section 16(b) should not require the forfeiture of his paper profits."[94]

After Kern's board approved the Tenneco offer on May 19, Occidental should not have been required to engage in a groundless proxy fight, involving other shareholders and use of the courts, or any other acts of opposition to the proposed merger as a condition of avoiding a § 16(b) liability. Nor should it have been required to feign displeasure at the

93. CCH Fed. Sec. L. Rep. ¶ 93,237 (S.D.N.Y., October 12, 1971) (withdrawn).

94. Comment, *Securities Regulation—Exchange of Stock Pursuant to Merger is "Sale" by an Insider Under Section 16(b) of the Securities Exchange Act of 1934*, *supra* note 92, at 1021-22 (footnote omitted).

prospect that, although its bid had failed, its investment might yet prove profitable (although here the option made profit uncertain). A decision encouraging a proxy fight or symbolic opposition to avoid liability merely mandates a wasteful charade of no benefit to the shareholders of any corporation involved.

Petitioner's position would place a defeated bidder in an impossible situation, which shows the "manifestly absurd and unfair result that can flow from such a *per se* black-letter rubric," *Petteys* v. *Butler, supra,* 367 F.2d at 535-36. The disfavored bidder would have to acquire control of the target corporation against all opposition merely to prevent a "disposition" within 6 months. To do so it would have to both outbid its opponent and engage in an expensive proxy fight and management contest. Even if it spent large sums on intercorporate warfare, it would probably fail and suffer § 16(b) liability in addition, for the candidate favored by the incumbents has both an enormous advantage by reason of its favored position and also a terrific incentive. If the favored candidate wins control and causes a merger within 6 months, it captures a "sure-thing" windfall in the form of its opponent's §16(b) "profits." The large number of shares necessarily involved will guarantee it a huge recovery. Indeed this prospect would permit the favored candidate to make an offer above reasonable levels, knowing that it could finance the offer from the defeated bidder's "profits." Yet the favored contestant will risk no § 16(b) liability in the contest, for one *in fact* dealing cozily with the target's management need not first acquire a large block of shares. It is clearly not the purpose of § 16(b) to reward the person who causes the alleged "disposition" nor to extract "profits" from the disfavored bidder. Such a construction converts the statute from one meant to prevent the unfair use of inside information into a weapon to protect management against efforts to change it, a clear perversion of its purpose.

Petitioner's position stands § 16(b) on its head. The statute operates against insider abuses by discouraging short-term transactions. But recovery here will encourage short-term "merger-sales" by ensuring a reward for those who cause them. Petitioner's theory would not merely permit those controlling the merger to decide *if* the losing bidder would suffer § 16(b) liability. They could also determine *how much* liability he would suffer by choosing a closing date when the merger stock reached their own view of its maximum price.[95] See *Newmark* v. *RKO General, Inc., supra,* 425 F.2d at 353.

Petitioner suggests that its construction would discourage only tender offers "made primarily with a manipulative objective in mind" (P. Br. 29). Quite to the contrary, the statute would not distinguish between bona fide tender offers and "manipulative" ones but only between mergers rushed through within six months and those which are not. Petitioner's position would only induce unsuccessful bidders to attempt to delay a proposed merger by proxy fights, litigation, or other artificial means, thereby making liability turn upon a bizarre contest between the opposing bidders to accelerate or retard the closing date.

The whole thrust of petitioner's argument conflicts with the judgment of Congress, which directly addressed the issue of control contests by cash tender offer in the Williams Act amendments of 1968.[96] Hearings showed that such offers

95. This would effectively compel the disfavored bidder to sell his merger stock for cash just to pay the recovery due—and thereby risk § 16(b) liability for that sale as well. The proceeds of such a sale would be unlikely to match the artificial "profits" he is thus forced to "realize," because his merger "sale" price might well be said to be the highest market quotation on the closing date, *cf. Blau* v. *Lehman,* 173 F. Supp. 590, 595 n.3 (S.D.N.Y. 1959), *aff'd,* 286 F.2d 786 (2 Cir. 1960), *aff'd,* 368 U.S. 403 (1962); *Marquette Cement Mfg. Co.* v. *Andreas, supra,* 239 F. Supp. at 968, while the actual proceeds would be measurably lower.

96. The Williams Act amendments to the Securities Exchange Act, §§ 13(d)-(e); 14(d)-(f) of the Act; 15 U.S.C. §§ 78m(d)-(e); 78n(d)-(f).

often stimulated or displaced inefficient management, to the benefit of all shareholders,[97] and Congressional committees decided that federal policy should not give significant advantages to either bidder or target:

> "The committee has taken *extreme care* to avoid tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid."[98]

In the Williams Act Congress dealt with cash tender offers by a balanced treatment of disclosure and regulation, inconsistent with petitioner's theory, which would penalize actual bidders and chill potential ones by automatically requiring them to reward their opponent with a huge recovery and thereby finance their own defeat.[99]

Petitioner seems to argue for a new presumption, unrelated to the use of inside information, by which all tender offerors would be held to foresee a short-term adversary merger, resting wholly upon testimony by the then Chairman of the SEC as to his "feelings" (P. Br. 29-30), without stating that the substance of his testimony was withdrawn by supplementary letter of the same date when members of the House committee requested evidentiary support.

> "After a review of our records, I find that we have no information on the total number of tender offers made during any recent period, on the spread between the tender prices and the market prices at the time the offers were made, on the number of offers which were successful during any recent period or on the number of persons who made tender

97. S. REP. No. 550, 90th Cong., 1st Sess. 3 (1967).

98. *Id.* (Emphasis added). The identical statement of policy appears in H.R. REP. No. 1711, 90th Cong., 2d Sess. 4 (1968).

99. As Judge Friendly noted, the only way a tender offeror could protect itself would be by limiting its bid to less than 10%, which, by emasculating the offer, would confer additional protection on incumbents, contrary to the Congressional judgment not to do so (13A n.15).

> offers and thereafter sold their holdings to persons making counter offers."[100]

Instead, studies, including one cited by the Chairman in retracting his testimony as the "most complete" available,[101] showed that incumbents have many tactics to resist share solicitations[102] and resort to a "defensive" merger only "if all else fails."[103] Another stated:

> "Realistically this is not a defense tactic, but rather a form of orderly retreat and *one would expect that unless such a merger was being actively considered prior to the tender offer, it would be viewed by incumbent management only as a last, albeit very effective, resort.*"[104]

More importantly all of the concerns raised over tender offer practices have "nothing to do with inside information" and thus nothing to do with § 16(b).[105] Congress has regulated tender offers in one way and can further regu-

100. *Hearings on H.R. 14475 & S. 510 Before Subcommittee on Finance and Commerce, House Committee on Interstate and Foreign Commerce*, 90th Cong., 2d Sess. 21 (1968).

101. *Id.*

102. Through such "defensive" measures as changes in capital and voting structures, placement of shares in friendly hands, stock repurchases, various methods to increase outstanding shares, increased dividends or promises thereof, litigation, and so forth, all used in connection with the prestige and informational advantage enjoyed by the incumbents. See, *e.g.*, O'Hanlon, *Goodrich's Four-Ply Defense*, FORTUNE, July 1969, at 110; Note, *Defensive Tactics Employed by Incumbent Management in Contesting Tender Offers*, 21 STAN. L. REV. 1104, 1111-27 (1969).

103. Hayes & Taussig, *Tactics of Cash Takeover Bids.*, 45 HARV. BUS. REV., Mar.-Apr. 1967, 135 at 146 (1967), reprinted in *Hearings on S. 510 Before Subcommittee on Securities, Senate Committee on Banking and Currency*, 90th Cong., 1st Sess. (1967), App. 2, at 222.

104. Schmults & Kelly, *Cash Take-Over Bids—Defense Tactics*, 23 BUS. LAW. 115, 132 (1967) (Emphasis added; footnote omitted).

105. Note, *Reliance Electric and 16(b) Litigation: A Return to the Objective Approach?*, *supra* note 33, at 911.

late them if it sees fit, but it has reserved the extraordinary remedy of § 16(b) for trading on inside information.

Petitioner has retreated from arguments it made below,[106] seeking to show that Occidental could have used information unfairly in the merger exchange, and instead attempts to "color" this case, stating that Occidental "threatened" a proxy fight and otherwise coerced Tenneco, so that Occidental could submit to an option. Such claims are contradicted by the record, but, more important, they are red herrings. This is a § 16(b) case. Submission to an option is not a sale; the merger was not a sale. This argument is merely a pooling of weaknesses and was properly rejected below:

> "Appellees argue finally that Occidental took advantage of its position to get something for itself that was not available to other Old Kern stockholders and that we should therefore consider this option as a 'sale,' despite the contrary implication of Silverman v. Landa. . . . Although we do not decide the point, appellees' argument might indeed have force if Occidental had acquired a 'put,' [a *right* to sell] . . . rather than having submitted itself to a 'call.' But the two situations are quite different . . ." (15A-16A),

and, in accordance with the record, ". . . we cannot see how Occidental took any advantage of its position here" (16A). Such argument was both legally irrelevant and factually without support.

The remaining points require only brief treatment. The first is the implication which petitioner seeks to draw from the Commission's response to a proposal, made by a committee of the Association of the Bar of the City of New York, which would have exempted from § 16(b) all mergers

106. In the Second Circuit petitioner presented hypotheses which it claimed would illustrate how a tender offeror could use post-offer information for an unfair trading advantage. We showed that each was specious, and they have not been repeated here.

and similar transactions in all circumstances on the theory that receipt of new securities should not be a "realization" under §16(b) (P. Br. 31). This blanket exemption, based upon an entirely different theory, covering all "purchase" and "sale" prototypes in all situations, is totally irrelevant to the questions at bar. See *Blau* v. *Lamb, supra,* 363 F.2d at 524.

The other is the claim that without an exemptive rule by the Commission the courts are powerless to prevent a perversion of the statute. Whether § 16(b) can be triggered by a defendant's being "disposed of" his shares by the acts of others, to the extent it is arguable, is a question for the courts, to which Congress has given the duty of enforcement. No "exemption" is needed where an alleged "sale" is not a matter of the defendant's choice, for prima facie there is no coverage by the statute. The Commission's position is consistent with this; it is presently arguing as amicus curiae in *Gold* v. *Scurlock, supra,* that because of defendants' active control, appraisal rights, and other options not to participate (none available here), a merger became their voluntary "purchase" and their subsequent cash sale of shares should trigger the Act.[107]

Even where claims are based on a defendant's own acts, courts of appeals have consistently rejected the argument that only a general exemptive rule can settle whether a problematical exchange of shares is a § 16(b) "purchase" or "sale."[108] Since "the primary duty of administering § 16(b)" is placed on the courts, while the Commission has only exemptive power, *Blau* v. *Max Factor & Co., supra,* 342 F.2d at 307 n.5, and "the purposes of the Act are stated clearly and appear side-by-side with the literal demands,"

107. Brief for SEC as Amicus Curiae at 19, *Gold* v. *Scurlock, supra, appeal pending,* No. 71-2180-82, 4 Cir.

108. *Newmark* v. *RKO General, Inc., supra,* 425 F.2d at 351; *Blau* v. *Max Factor & Co., supra,* 342 F.2d at 307 n.5; *Petteys* v. *Butler, supra,* 367 F.2d at 536; *Blau* v. *Lamb, supra,* 363 F.2d at 519.

Petteys v. *Butler*, *supra*, 367 F.2d at 536, courts must decide whether a case comes within the statutory language, read in the light of its expressed purpose. This has been the rule since *Shaw* v. *Dreyfus*, *supra*, in 1949. Congress has been well aware of this application of the statute, and it must be regarded as a settled issue.[109]

The Second Circuit here properly rejected an unjustified construction of the Act which would have perverted its purpose. It had no need to reach the unfair result that those claiming recovery based on their own acts should extract a reward from one who in fact caused benefits to inure to all shareholders, as tender offers often do, and thus repel future offers. It did not weigh any "equities," as petitioner claims, and it so stated, since it did not regard the substantive § 16(b) question as even close (12A). But it was not required to suppress its apprehension over the necessary consequences of petitioner's position (13A). Its decision was plainly correct.

109. The Commission has noted that: "The Act makes such profits recoverable in private litigation, thus placing upon the courts the ultimate responsibility for the interpretation of Section 16(b). . . ." SEC Securities Exchange Act Release No. 4509 (Oct. 30, 1950). "The question whether liabilities under Section 16(b) will arise from transactions is, of course, to be determined by the facts of each particular case in an appropriate action brought by the issuer or its security holders." SEC Securities Exchange Act Release No. 7824 (Feb. 14, 1966); see SEC Securities Exchange Act Release No. 9499 (Feb. 23, 1972).

CONCLUSION

The judgment of the Court of Appeals for the Second Circuit is correct in its application of § 16(b) to both issues presented and should be affirmed.

Respectfully submitted,

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September 15, 1972.